Popular Annual Financial Report for the Year ended June 30, 2018
City of San Jose, California
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, 2018. 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 2018, the Defined Benefit Pension Plan returned 6.3% gross of fees and 5.9% net of fees, while the Policy Benchmark return for the same time period was 7.4%. The System's fiscal year performance was slightly below the actuarial rate of return of 6.875%. For fiscal year 2018, the Postemployment Healthcare Plan returned 4.9% net of fees.

The System engages an independent actuary to conduct annual actuarial valuations. The June 30, 2017 actuarial valuations show that the Defined Benefit Pension Plan and the Postemployment Healthcare Plan are 53.6% and 39.4% funded, respectively. The Defined Benefit Pension Plan sponsor paid 100% of the Actuarially Determined Contribution in fiscal year 2018, 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, 2018 were:

Matt Loesh	Chair	Employee representative
Michael Armstrong	Vice Chair	Public member
Martin Dirks	Trustee	Public member
Anurag Chandra	Trustee	Public member
Jay Castellano	Trustee	Retired plan member
Kurt Billick	Trustee	Public member
Vacant	Trustee	Employee representative
Devora "Dev" Davis	Non-voting	Council member

Net Position Held in Trust

As of June 30, 2018, the System's total plan net position for the Defined Benefit Pension Plan totaled $2.1 billion, while the Postemployment Healthcare Plan net position totaled $277.3 million. The funded ratio for the Defined Benefit Plan and Postemployment Healthcare Plan is 53.6% and 39.4% respectively, as of June 30, 2017, 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, 2018 and 2017 (In Thousands)*

	2018	2017	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Receivables	$ 12,416	$ 68,585	$ (56,169)	(81.9)%
Investments at fair value	2,062,101	1,918,487	143,614	7.5 %
Capital assets	1,684	1,448	236	16.3 %
Total Assets	**2,076,201**	**1,988,520**	**87,681**	**4.4 %**
Current liabilities	6,868	15,728	(8,860)	(56.3)%
Total Liabilities	**6,868**	**15,728**	**(8,860)**	**(56.3)%**
Plan Net Position	**$ 2,069,333**	**$ 1,972,792**	**$ 96,541**	**4.9 %**

NET POSITION FOR THE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S POSTEMPLOYMENT HEALTHCARE PLAN *As of June 30, 2018 and 2017 (In Thousands)*

	2018	2017	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Receivables	$ 4,211	$ 5,944	$ (1,733)	(29.2)%
Investments at fair value	273,442	270,727	2,715	1.0 %
Capital assets	70	66	4	6.1 %
Total Assets	**277,723**	**276,737**	**986**	**0.4 %**
Current liabilities	466	16,367	(15,901)	(97.2)%
Total Liabilities	**466**	**16,367**	**(15,901)**	**(97.2)%**
Plan Net Position	**$ 277,257**	**$ 260,370**	**$ 16,887**	**6.5 %**

Changes in Net Position **for the years ended June 30, 2018 and 2017**

As of June 30, 2018, the net position restricted for pension benefits increased by $96.5 million or 4.9% over 2017, due to total additions being greater than total deductions. However, total additions decreased by $(6,956,000) mainly as a result of the decrease in net investment income of $(28,517,000), due to less favorable market conditions in 2018 compared to 2017, which was offset with the increase in employer contributions. In addition, total deductions increased by $10,413,000, due to an increase in benefit payments from rising pension benefit costs caused by an increase in the number of retirees, as well as the increase in the final average salary used to calculate the pension benefits.

CHANGES IN PLAN NET POSITION FOR THE DEFINED BENEFIT PENSION PLAN

For the Fiscal Years Ended June 30, 2018 and 2017 (In Thousands)

	2018	2017	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Employee contributions	$ 20,501	$ 17,227	$ 3,274	19.0 %
Employer contributions	156,770	138,483	18,287	13.2 %
Net investment income*	117,493	146,010	(28,517)	19.5 %
Total Additions	**294,764**	**301,720**	**(6,956)**	**(2.3)%**
Retirement benefits	179,366	169,756	9,610	5.7 %
Death benefits	12,970	12,411	559	4.5 %
Refund of contributions	1,064	1,263	(199)	(15.8)%
Administrative expenses	4,823	4,380	443	10.1 %
Total Deductions	**198,223**	**187,810**	**10,413**	**5.5 %**
Net Increase in Plan Net Position	**96,541**	**113,910**	**(17,369)**	**(15.2)%**
Beginning Net Position	**1,972,792**	**1,858,882**	**113,910**	**6.1 %**
Ending Net Position	**$ 2,069,333**	**$ 1,972,792**	**$ 96,541**	**4.9 %**

** Net of investment expenses of $10,734 and $11,827 in 2018 and 2017, respectively.*

As of June 30, 2018, the net position restricted for postemployment healthcare benefits increased by $16.9 million or 6.5% over 2017, due to total additions being greater than total deductions. However, total additions decreased by $(5,495,000) mainly as a result of the decrease in net investment income of $(4,705,000), due to less favorable market conditions in 2018 compared to 2017. In addition, total deductions increased by $12,142,000, due to the implementation of the Voluntary Employee Beneficiary Association (VEBA), which transferred assets out of the postemployment healthcare plan and into the VEBA defined contribution plan. The VEBA is administered by the City and not the Office of Retirement Services.

CHANGES IN PLAN NET POSITION FOR THE POSTEMPLOYMENT HEALTHCARE PLAN

For the Fiscal Years Ended June 30, 2018 and 2017 (In Thousands)

	2018	2017	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Employee contributions	$ 15,545	$ 16,827	$ (1,282)	(7.6)%
Employer contributions	32,397	31,905	492	1.5 %
Net investment income / (loss)*	12,336	17,041	(4,705)	(27.6)%
Total Additions	**60,278**	**65,773**	**(5,495)**	**(8.4)%**
Healthcare insurance premiums	29,724	31,007	(1,283)	(4.1)%
Administrative expenses	170	242	(72)	(29.8)%
VEBA Transfer	13,497	-	13,497	100.0 %
Total Deductions	**43,391**	**31,249**	**12,142**	**38.9 %**
Net Increase in Plan Net Position	**16,887**	**34,524**	**(17,637)**	**(51.1)%**
Beginning Net Position	**260,370**	**225,846**	**34,524**	**15.3 %**
Ending Net Position	**$ 277,257**	**$ 260,370**	**$ 16,887**	**6.5 %**

** Net of investment expenses of $403 and $706 in 2018 and 2017, respectively.*

Changes in Net Position for the years ended June 30, 2018 and 2017 *(continued)*

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, 2018 and 2017)

	Retirees and beneficiaries currently receiving benefits*		Terminated vested members not yet receiving benefits		Active members		Total	
PENSION	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**
Tier 1 Pension only **	595	-	858	-	193	-	1,646	-
Tier 1 Pension & Medical***	3,627	4,114	164	1,037	1,662	1,991	5,453	7,142
Tier 2 Pension only **	3	1	412	250	1,610	1,255	2,025	1,506
Tier 2 Pension & Medical***	-	-	-	65	89	164	89	229
Total	**4,225**	**4,115**	**1,434**	**1,352**	**3,554**	**3,410**	**9,213**	**8,877**
HEALTHCARE								
Tier 1 Pension & Medical****	3,627	3,535	164	158	1,662	1,991	5,453	5,684
Tier 2 Pension & Medical****	-	-	-	-	89	164	89	164
Total	**3,627**	**3,535**	**164**	**158**	**1,751**	**2,155**	**5,542**	**5,848**

**The combined domestic relations orders are not included in the count above as their benefit payment is included in the retiree member count.*
*** Includes members that are eligible for catastrophic disability medical benefits only (VEBA) from the Postemployment Healthcare plan.*
**** Eligible for full retiree medical benefits.*
***** Payees that have health and/or dental coverage.*

Average Benefit Payments

The Average Benefit Payment chart is a broad representation of average benefits paid to retirees and survivors. All tiers are combined in the calculation. The chart includes all members who have retired through June 30, 2018.

PENSION	Years of Service Credit						
Time Periods	**0-5**	**6-10**	**11-15**	**16-20**	**21-25**	**26-30**	**31+**
Average monthly benefit*	$1,020	$1,642	$2,685	$3,603	$5,035	$6,202	$6,889
Average final average monthly salary	$6,320	$5,872	$5,957	$6,000	$6,524	$6,461	$6,475
Number of retired members**	173	485	550	738	653	968	138

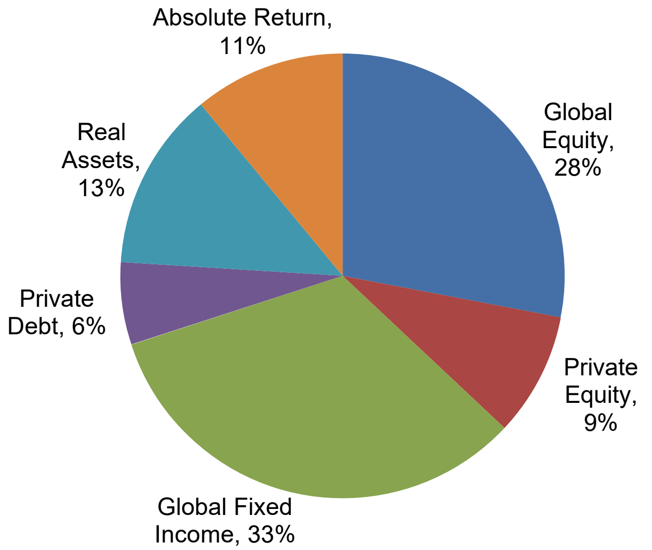
HEALTHCARE	Years of Service Credit						
Time Periods	**0-5**	**6-10**	**11-15**	**16-20**	**21-25**	**26-30**	**31+**
Average health subsidy	$642	$472	$570	$563	$597	$654	$550
Number of health participants**	18	25	266	686	618	936	133
Average dental subsidy	$85	$84	$89	$89	$92	$94	$84
Number of dental participants**	59	244	392	623	582	933	138

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

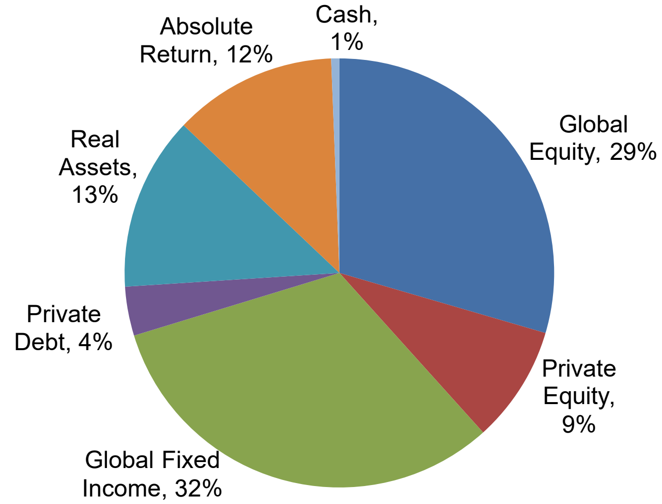
Asset Allocation (as of June 30, 2018)

The allocation of the System's assets is an integral part of the System's investment policy. As such, the System engages in periodic 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.

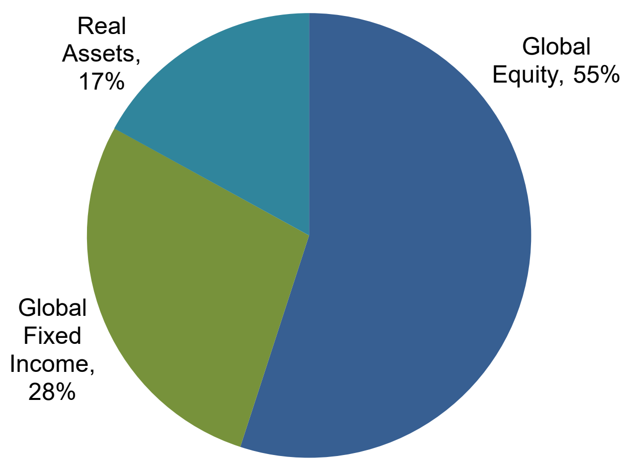
PENSION - TARGET ASSET ALLOCATION



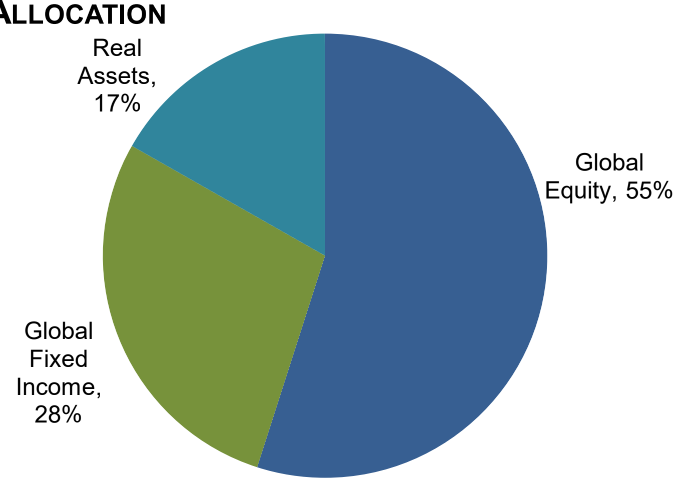
PENSION - ACTUAL ASSET ALLOCATION



HEALTHCARE - TARGET ASSET ALLOCATION



HEALTHCARE - ACTUAL ASSET ALLOCATION



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

Absolute return includes hedge funds.

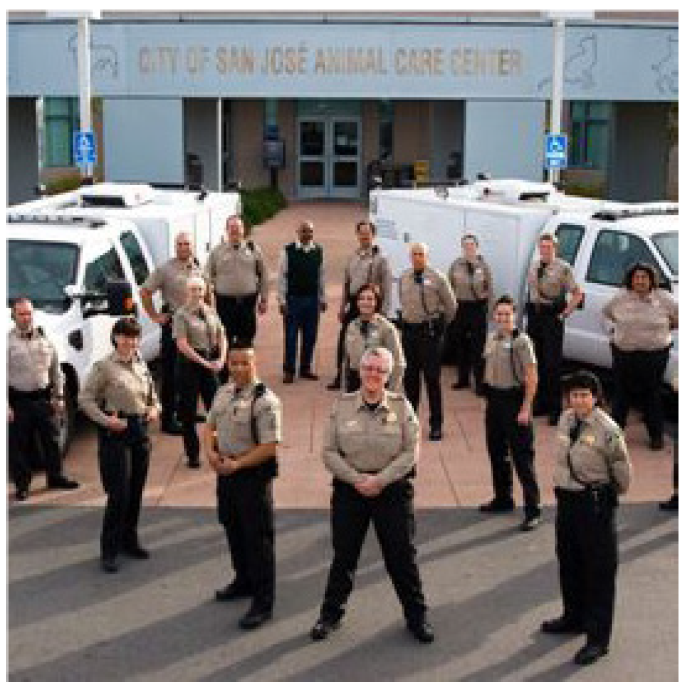
Investment Returns Based on Fair Value* **(as of June 30, 2018)**

PENSION	One Year	Three Years	Five Years	Ten Years
Global equity	9.2%	7.2%	8.8%	N/A
Private equity	8.9%	7.1%	10.7%	7.2%
Absolute return	4.8%	2.0%	3.2%	N/A
Real assets	11.1%	4.8%	4.3%	N/A
Global fixed income	1.0%	1.8%	1.8%	N/A
Private debt	(5.4)%	0.2%	2.9%	N/A
Total fund (net)	**5.9%**	**4.2%**	**5.0%**	**4.1%**
Policy benchmark	**7.4%**	**5.6%**	**5.9%**	**5.0%**

HEALTHCARE	One Year	Three Years	Five Years
Global equity	9.2%	7.5%	9.2%
Global fixed income	0.1%	1.4%	1.8%
Real assets	9.6%	2.5%	(0.9)%
Total fund (net)	**4.9%**	**3.5%**	**4.6%**
Policy benchmark	**7.9%**	**5.8%**	**6.0%**

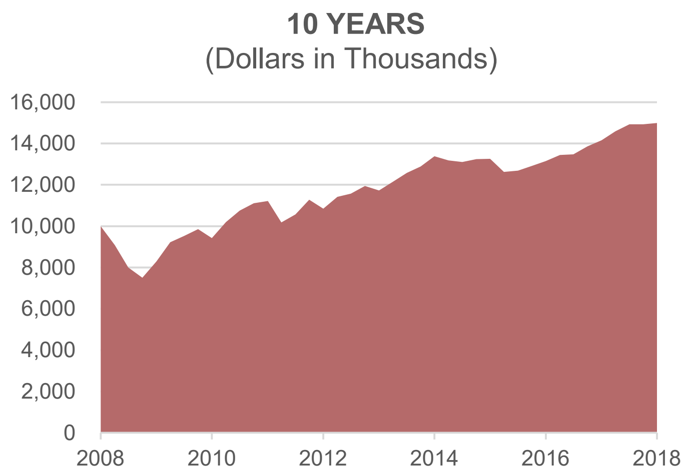
** Using time-weighted rate of return based on the market rate of return*

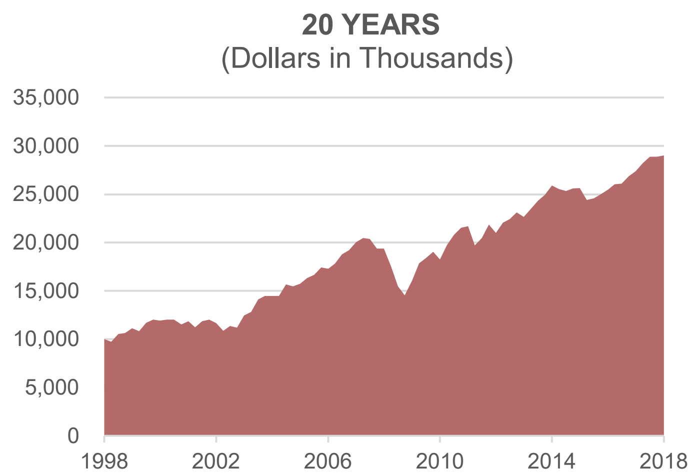
As stated in the System's investment policy, "the primary objective of the investment portfolio is to satisfy the System's obligations to pay benefits to members of the System and their beneficiaries. To do so, the Fund will seek to achieve long-term net returns in excess of the actuarial investment 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, 2018, the Defined Benefit Pension Plan returned 5.9% net of fees, while the Policy Benchmark return for the same period was 7.4%.



Growth of $10,000 **(as of June 30, 2018)**

Below are graphic trends to show how much an initial investment of $10,000 would be worth in the Retirement System's pension portfolios after 10 years and 20 years. There is not enough data available to show 30 years.

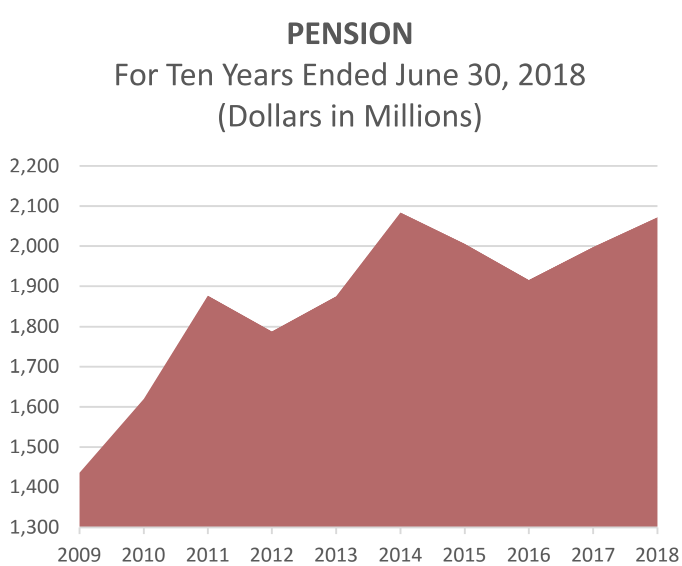


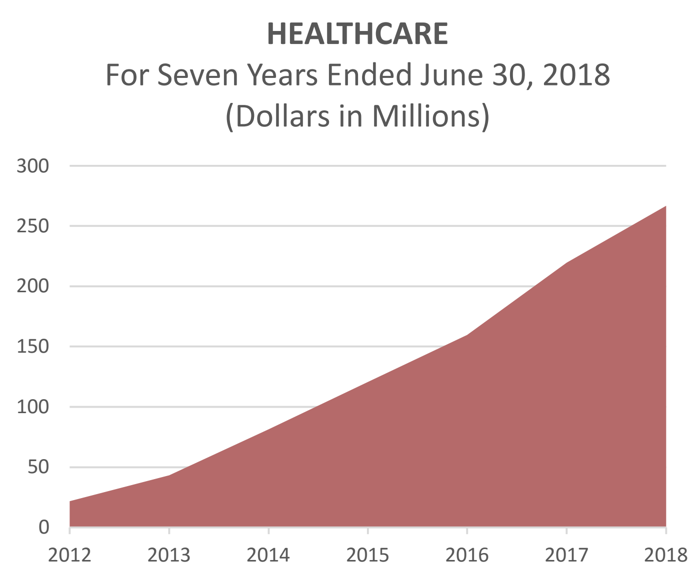


Source: State Street

Market Value Growth of Plan Assets **(as of June 30, 2018)**

Below are the market value growth of pension and healthcare plan assets for the years ended June 30, 2018.





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 reports that was current as of June 30, 2017; please check the System's website for more current numbers and information on the Net Pension Liability calculation required by GASB 67 and the Net OPEB Liability calculation required by GASB 74.

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, 2017	$2,101,435	$3,923,966	$1,822,531	53.6%	$287,339	634.0%
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%

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, 2017	$248,583	$630,452	$381,869	39.4%	$287,339	132.9%
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%

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, 2018	$156,770	$20,501	$32,397	$15,545
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

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

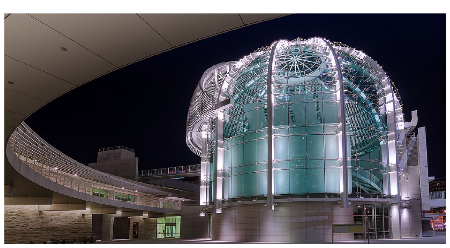
The Office of Retirement Services began the implementation of its pension administration system in March 2015. The implementation process is expected to last approximately 42 months and is estimated at $9 million. ORS has completed the user acceptance testing for Software Deliverable 5 (the last planned deliverable) and is currently training staff on the new system, as well as starting the parallel processing phase of the implementation. The project completion was extended to the summer of 2019 for the implementation of Measure F-related calculations in the sytem.

ORS has been working on a pensionable pay correction (PPC) project for several years. The purpose is to correct retirement benefits paid to some retirees, due to errors in the City's reporting to ORS of pensionable pay information that was then used in the members' benefit calculation. The correction project impacting the System includes adjustments in non-pensionable higher class pay and lump-sum PeopleSoft retroactive payments needing to be spread to appropriate pay periods. ORS made significant progress with the PPC project for the members of the System by holding informational meetings, inviting the membership to the Board meetings to discuss the correctional plan and implementing the correctional plan. In August 2018, corrections to the ongoing monthly benefit payments were made to the underpaid members affected by the PPC project, as well as disbursements were made to these members for any past underpaid amounts, including interest. As for the overpaid members impacted by the PPC project, the Board approved at its August 2018 meeting to collect the cumulative overpaid amount from the City for these members and make the corrections to their ongoing monthly benefit payments in October 2018.

In November 2016, Measure F passed, and on June 16, 2017, the ordinance implementing the Framework and Measure F became effective for employees in the System. 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 Employee Beneficiary Association (VEBA) for retiree healthcare and an irrevocable opt-out of the defined benefit retiree healthcare plan for eligible employees, defining the qualifications for members of the independent medical panel, and creating a Guaranteed Purchasing Power (GPP) benefit for Tier 1 retirees. The VEBA is being administered by the City, not ORS and therefore it is also not under the jurisdiction of the Retirement Board.

During this fiscal year, ORS completed most of the implementation of Measure F, with the transfer of the contributions of members who opted in to the VEBA. In addition, ORS made the first payments to those affected by the GPP and included the retiree healthcare in-lieu premium credit as part of the open enrollment process for retirees. Retirees who are eligible for medical insurance and/or dental insurance but who opt not to take it, can elect to be in the in-lieu credit program. These members are given credits worth 25% of the lowest cost plan, which can be used in future years if the retiree opts to enroll in a City medical or dental plan. There are still a few aspects of Measure F that are outstanding such as the medical panel and the refinement of the Municipal Code to be consistent with the current procedures of the City.

In October 2017, the City Auditor issued report 17-06, *Audit of Retirement Services: Greater Transparency Needed in the Budgeting Process, Interactions Among Stakeholders, Investment Policies, and Plan Administration*. This audit was a result of a request from the Mayor’s Office, in which concern was expressed that although ORS’ administrative budget has increased since fiscal year 2005-2006, the plans had seen losses in the two fiscal years prior to fiscal year 2017. The report was published with five separate findings which are covered in 25 different recommendations. Four of the 25 recommendations are addressed to the City, and ORS has addressed and completed most of the findings over which they have control. In addition to this audit, the City Auditor conducted a pensionable earnings audit but the result was favorable, and no recommendations to ORS came out of it.



Awards for Excellence in Financial Reporting

The System's CAFR for the year ended 2018, from which information on pages 1-7 has been drawn, was awarded the Certificates of Achievement for Excellence in Financial Reporting by Government Finance Officers Association of the United States and Canada (GFOA) for the year ended June 30, 2017. The Certificate of Achievement is 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, 2017. The Award for Outstanding Achievement in Popular Annual Financial Reporting is a prestigious national award recognizing conformance with the highest 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 second year for the fiscal year ended June 30, 2017. 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 2017. 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.