



Office of the Washington State Auditor
Pat McCarthy

Financial Statements Audit Report

Tacoma Employees' Retirement System

Pierce County

For the period January 1, 2017 through December 31, 2017

Published June 28, 2018

Report No. 1021611





**Office of the Washington State Auditor
Pat McCarthy**

June 28, 2018

The Honorable Mayor and members of the Board of Administration
Tacoma Employees' Retirement System
Tacoma, Washington

Report on Financial Statements

Please find attached our report on the Tacoma Employees' Retirement System's financial statements.

We are issuing this report in order to provide information on the Retirement System's financial condition.

Sincerely,

A handwritten signature in black ink that reads "Pat McCarthy". The signature is written in a cursive, flowing style.

Pat McCarthy
State Auditor
Olympia, WA

TABLE OF CONTENTS

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.....	4
Independent Auditor's Report on Financial Statements.....	7
Financial Section.....	11
About the State Auditor's Office.....	42

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

**Tacoma Employees' Retirement System
Pierce County
January 1, 2017 through December 31, 2017**

The Honorable Mayor and members of the Board of Administration
Tacoma Employees' Retirement System
Tacoma, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Tacoma Employees' Retirement System, a fiduciary fund of the City of Tacoma, Pierce County, Washington, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the Retirement System's basic financial statements, and have issued our report thereon dated June 18, 2018.

The financial statements present only the Tacoma Employees' Retirement System and do not purport to, and do not, present fairly the financial position of the City of Tacoma, Washington as of December 31, 2017, the changes in its financial position or where applicable its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

The financial statements include pension trust fund investments valued at \$1.72 billion, which comprise 95.4 percent of total assets and 95.4 percent of total net position restricted for pensions. The fair values of these investments have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or, in the case of investments in partnerships, the general partners.

The prior year comparative information has been derived from the Retirement System's 2016 basic financial statements, on which we issued our report dated May 25, 2017.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the Retirement System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Retirement System's internal control. Accordingly, we do not express an opinion on the effectiveness of the Retirement System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Retirement System's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the Retirement System's financial statements are free from material misstatement, we performed tests of the Retirement System's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Retirement System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Retirement System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

A handwritten signature in black ink that reads "Pat McCarthy". The signature is written in a cursive, flowing style.

Pat McCarthy
State Auditor
Olympia, WA

June 18, 2018

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Tacoma Employees' Retirement System Pierce County January 1, 2017 through December 31, 2017

The Honorable Mayor and members of the Board Administration
Tacoma Employees' Retirement System
Tacoma, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Tacoma Employees' Retirement System, a fiduciary fund of the City of Tacoma, Pierce County, Washington, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the Retirement System's basic financial statements as listed on page 11.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Retirement System's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Retirement System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tacoma Employees' Retirement System, as of December 31, 2017, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Matter of Emphasis

As discussed in Note 1, the financial statements present only the Tacoma Employees' Retirement System and do not purport to, and do not, present fairly the financial position of the City of Tacoma, Washington as of December 31, 2017, the changes in its financial position, or where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As explained in Note 2, the financial statements include pension trust fund investments valued at \$1.72 billion, which comprise 95.4 percent of total assets and 95.4 percent of total net position restricted for pensions. The fair values of these investments have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or, in the case of investments in partnerships, the general partners. Our opinion was not modified with respect to this matter.

Other Matters

Report on summarized Comparative Information

The financial statements include partial prior year comparative information. Such information does not include all of the information required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Retirement System's financial statements for the year ended December 31, 2016, from which such partial information was derived. We have previously audited the Retirement System's 2016 financial statements and we expressed an unmodified opinion in our report dated May 25, 2017. In our opinion the summarized comparative information presented herein as of and for the year ended December 31, 2016, is consistent in all material respects with the audited financial statements from which it has been derived.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information listed on pages 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Retirement System's basic financial statements. The Schedule of Administrative Expenses, Schedule of Payments to Consultants, Schedule of Investment Expenses and Schedule of Proportionate Share by Employer are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional

procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated June 18, 2018 on our consideration of the Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Retirement System's internal control over financial reporting and compliance.



Pat McCarthy
State Auditor
Olympia, WA

June 18, 2018

FINANCIAL SECTION

Tacoma Employees' Retirement System Pierce County January 1, 2017 through December 31, 2017

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2017

BASIC FINANCIAL STATEMENTS

Statement of Fiduciary Net Position – 2017

Statement of Changes in Fiduciary Net Position – 2017

Notes to the Basic Financial Statements – 2017

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Changes in Net Pension Liability or Asset of Employers and Related Ratios
– 2017

Schedule of Net Pension Liability or Asset of Employers – 2017

Schedule of Employers' Contributions – 2017

Schedule of Contribution Rates – 2017

Schedule of Investment Returns – 2017

Notes to Required Supplementary Information – 2017

SUPPLEMENTARY AND OTHER INFORMATION

Schedule of Administrative Expenses – 2017

Schedule of Payments to Consultants – 2017

Schedule of Investment Expenses – 2017

Schedule of Proportionate Share by Employer – 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

The discussion and analysis of the Tacoma Employees' Retirement System (TERS) financial condition provides an overview of the financial activities and funding conditions for the calendar years ended December 31, 2017, 2016 and 2015. The intent of this discussion and analysis is to give a narrative overview and analysis of the System's financial performance as a whole. For more detailed information, readers should also review the financial statements, notes to the financial statements, and required supplementary information in order to enhance their understanding of the System's financial performance.

Overview of Financial Statements

TERS financial statements were prepared in conformity with GASB Statement No. 67, *Financial Reporting for Pension Plans*, and are comprised of the following components:

1. Statement of Fiduciary Net Position,
2. Statement of Changes in Fiduciary Net Position,
3. Notes to the Basic Financial Statements,
4. Required Supplementary Information, and
5. Other Supplementary Information

Statement of Fiduciary Net Position. The Statement of Fiduciary Net Position provides information about the System's assets, liabilities and net position. It is a snapshot of the financial position of the System as of the end of the year 2017.

Statement of Changes in Fiduciary Net Position. The Statement of Changes in Fiduciary Net Position illustrates how TERS' net position changed during the calendar year, reflecting contributions accrued, benefit payments made, investment returns earned, and expenses paid to administer the System.

Notes to the Basic Financial Statements. The Notes to the Basic Financial Statements provide additional information that is essential to a complete understanding of the data provided in the Basic Financial Statements.

Required Supplementary Information. The Required Supplementary Information consists of schedules of changes in net pension liability or asset of employers, employers' net pension liability or asset, employers' contributions, contribution rates, proportionate share by employers and the money-weighted long-term rate of investment return for TERS.

Other Supplementary Information. The Other Supplementary Information includes details on administrative expenses, payments to consultants, and investment-related expenses.

Summary of Statement of Fiduciary Net Position

The table below provides a summary of assets and current liabilities for the years ended December 31.

	2017	2016	2015	2017-2016 Percentage Change	2016-2015 Percentage Change
Cash and short-term investments	\$ 35,448,884	\$ 21,611,257	\$ 23,508,989	64.03 %	(8.07) %
Receivables	5,323,232	7,170,877	6,637,392	(25.77)	8.04
Investments	1,727,359,837	1,543,239,942	1,439,664,687	11.93	7.19
Securities lending collateral	41,989,985	56,921,493	41,071,697	(26.23)	38.59
Capital assets, net of accumulated depreciation	10,129	10,973	11,817	(7.69)	(7.14)
Total assets	<u>1,810,132,067</u>	<u>1,628,954,542</u>	<u>1,510,894,582</u>	11.12	7.81
Accounts payable and other liabilities	1,999,360	1,869,716	1,829,700	6.93	2.19
Investment purchases	42,893,200	22,499,616	19,297,997	90.64	16.59
Securities lending collateral	41,989,985	56,921,493	41,071,697	(26.23)	38.59
Total liabilities	<u>86,882,545</u>	<u>81,290,825</u>	<u>62,199,394</u>	6.88	30.69
Net position restricted for pensions	<u>\$1,723,249,522</u>	<u>\$1,547,663,717</u>	<u>\$1,448,695,188</u>	11.35	6.83

In 2017, the overall financial position of the System reflects an increase in fiduciary net position in comparison to the prior years due to a strong return on investments. The total investment return in 2017 was positive 13.40%, compared to 9.10% in 2016 and negative 0.14% in 2015. The details of the investment performance are located in the Investment Section of this report.

The System has no long-term liabilities. The bulk of the liabilities at year-end are related to investment purchases that did not settle until early 2018, accrued administrative and investment expenses, and securities lending collateral.

Summary of Statement of Changes in Fiduciary Net Position

The table below provides a summary of the changes in fiduciary net position and reflects the activities of the System for the years ended December 31.

	2017	2016	2015	2017-2016 Percentage Change	2016-2015 Percentage Change
Total contributions	\$ 49,100,277	\$ 47,943,361	\$ 45,815,864	2.41 %	4.64 %
Net investment income	205,616,277	124,939,177	(5,332,611)	64.57	(2442.93)
Total additions	254,716,554	172,882,538	40,483,253	47.34	327.05
				0.00	
Benefits and refunds of contributions	77,467,644	71,996,054	68,607,774	7.60	4.94
Administrative expenses	1,663,105	1,917,955	1,727,099	(13.29)	11.05
Total deductions	79,130,749	73,914,009	70,334,873		5.09
				0.00	
Net increase (decrease)	175,585,805	98,968,529	(29,851,620)	77.42	(431.53)
				0.00	
Net position beginning of year	1,547,663,717	1,448,695,188	1,478,546,808	6.83	(2.02)
Net position end of year	\$ 1,723,249,522	\$ 1,547,663,717	\$ 1,448,695,188	11.35	6.83

Additions to Fiduciary Net Position consist of employer and employee contributions, investment income, and net realized and unrealized gains on investments. For calendar year 2017, the total additions to the fiduciary net position were up from \$172.9 million in 2016 to \$254.7 million, or a 47.34% increase due to strong investment returns. The total contributions in 2017 were \$49.1 million or a 2.41% increase compared to 2016.

Deductions to Fiduciary Net Position consist of benefit payments, refunds, and administrative expenses. During 2017, benefits and refunds totaled \$77.5 million compared to \$72 million in 2016, or a 7.6% increase. The total administrative expenses for calendar year 2017 were 13.29% lower than 2016 mainly due to reduced costs related to professional services. In 2016, TERS had embarked on different undertakings, including an Actuarial Experience Study and information technology (IT) related projects to improve business processes, which resulted in higher professional services fees.

Contacting Tacoma Employees' Retirement System

This financial report is intended to provide its readers with a general overview of the System's finances and to demonstrate accountability for funds, revenues and distributions. If you have questions about this report or need additional information, please contact us at:

Tacoma Employees' Retirement System
 Tacoma Public Utilities, Administration Building
 3628 South 35th Street
 Tacoma, Washington 98409
 Email: tersretirement@cityoftacoma.org
 Telephone: (253) 502-8200/ 1-888-404-3787/Fax: (253) 502-8660

Statement of Fiduciary Net Position
As of December 31, 2017 and December 31, 2016

	2017	2016
Assets		
Cash and short-term investments	\$ 35,448,884	\$ 21,611,257
Receivables		
Contributions and other receivables	868,101	1,028,081
Interest and dividends	2,490,450	2,595,511
Investment sales	1,964,681	3,547,285
Total receivables	\$ 5,323,232	\$ 7,170,877
Investments, at fair value		
Equities	945,892,873	837,165,322
Fixed income	576,353,374	531,001,553
Real estate	70,970,834	80,382,335
Venture capital and partnerships	134,142,756	94,690,731
Total investments	\$ 1,727,359,837	\$ 1,543,239,942
Securities lending collateral	41,989,985	56,921,493
Capital assets, net of accumulated depreciation	10,129	10,973
Total assets	<u>\$ 1,810,132,067</u>	<u>\$ 1,628,954,542</u>
Liabilities		
Accounts payable and other liabilities	\$ 1,999,360	\$ 1,869,716
Investment purchases	42,893,200	22,499,616
Securities lending collateral	41,989,985	56,921,493
Total liabilities	<u>\$ 86,882,545</u>	<u>\$ 81,290,825</u>
Net position restricted for pensions	<u>\$ 1,723,249,522</u>	<u>\$ 1,547,663,717</u>

See accompanying Notes to the Financial Statements.

**Statement of Changes in Fiduciary Net Position
For the Years Ended December 31, 2017 and 2016**

	2017	2016
Additions		
Contributions		
Employer	\$ 26,091,331	\$ 25,536,034
Plan member	23,008,946	22,407,327
Total contributions	\$ 49,100,277	\$ 47,943,361
Investment income		
Net appreciation		
in fair value of investments	\$ 180,408,721	\$ 99,869,630
Interest & dividends	32,054,547	31,162,389
Investment management fees	(6,275,625)	(5,909,464)
Securities lending - agent fees	(80,824)	(75,097)
Securities lending - broker rebates	(490,542)	(108,282)
Net investment income	\$ 205,616,277	\$ 124,939,177
Total additions	\$ 254,716,554	\$ 172,882,538
Deductions		
Benefits	\$ 75,046,971	\$ 70,122,441
Refunds of contributions	2,420,673	1,873,613
Administrative expenses	1,663,105	1,917,955
Total deductions	\$ 79,130,749	\$ 73,914,009
Net Increase	175,585,805	98,968,529
Net position restricted for pensions		
Beginning of year	1,547,663,717	1,448,695,188
End of year	\$ 1,723,249,522	\$ 1,547,663,717

See accompanying Notes to the Financial Statements.

Notes to the Basic Financial Statements

December 31, 2017

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Plan Provisions

Description: The Tacoma Employees' Retirement System (the System) is a cost-sharing, multiple-employer defined benefit public employee pension plan, covering a majority of the employees of the City of Tacoma, and three Member Public Agencies. It has been administered in accordance with Tacoma Municipal Code Chapter 1.30 and the Revised Code of Washington Chapter 41.28.

The System is included in the Pension and Other Employee Benefit Trust Funds section of the City's Comprehensive Annual Financial Report (CAFR).

Administration: At the direction of the City Council, the System is administered by the Board of Administration (the Board) consisting of nine regular members and one alternate member. The members of the Board are: the Mayor, who serves as Chair; the Director of Finance; the City Manager (or designee); the Public Utilities Director (or designee); three elected employee representatives; one elected retired representative; and one City resident (not employed by the City) elected by the other eight members. The nine Board members appoint a TERS member, either active or retired, as an alternate Board member. The Board is required by the Tacoma Municipal Code to make annual reports to the City Council on the financial condition of the Retirement System. The Board, subject to City Council approval, appoints the Director who is responsible for managing the daily operations of the System.

Membership: Substantially all employees of the City of Tacoma are members of the System, with the exception of police officers, firefighters, and Tacoma Rail employees, who are covered by state or federal retirement plans. Other members include employees of the Tacoma-Pierce County Health Department, and certain employees of the Pierce Transit and the South Sound 911 (formerly known as Law Enforcement Support Agency) who established membership in the System when these agencies were still City of Tacoma departments. The breakdown of membership as of December 31, 2017 is as follows:

Retirees and beneficiaries currently receiving benefits	2,396
Terminated vested and other terminated participants	715
Active members:	
City of Tacoma	2,677
Pierce Transit	8
South Sound 911	2
Tacoma-Pierce County Health Department	<u>261</u>
Total active members	2,948
Total membership	<u><u>6,059</u></u>

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

Benefits: There are two formulas to calculate the retirement benefits. The benefit paid will be based on the formula which provides the higher benefit. The most commonly applied formula, "service retirement", is a product of the member's highest average monthly salary for a consecutive 24-month period, the number of years of membership credit, and a percentage factor (2% maximum) that is based on the member's age and years of service. The other formula is an annuity based on member contributions. There are several options available for the retiree to provide for their beneficiaries. The System also provides death, disability and deferred or postponed retirement for those former members who separated and retire later under the retirement eligibility requirements similar to immediate retirement. Additionally, the System provides cost of living adjustment (COLA) increases up to 2.125% as of July 1st of each year; the actual COLA granted is dependent on the Consumer Price Index (Seattle Area - all items) over the preceding calendar year.

Any active member who has not retired, and has five or more years of service as a member may purchase up to five additional years of service at the time of retirement. Total service including service purchased cannot exceed 30 years.

The System participates in the portability of public retirement benefits in Washington State public retirement. As provided under Chapter 41.54 of the RCW, this allows a member to use all years of service with qualified Washington systems to determine retirement eligibility and percentage factor for benefits under the System.

Funding Policy: The participating employers are responsible for funding the System at a level sufficient to pay obligations and ensure the actuarial and financial soundness of the System. Contribution rates for the employer and the employee are recommended by the Board of Administration and final approval rests with the Tacoma City Council. Currently, the required contribution rate for employees is 9.20% of their regular gross pay; the employer contributes 10.80%, for a combined total of 20.00%, which is sufficient to amortize the Unfunded Actuarial Accrued Liability (UAAL) of the System if future experience follows all actuarial assumptions. Changes to the contribution rate are subject to Sections 1.30.340 and 1.30.360 of the Tacoma Municipal Code.

(b) Method of Accounting

The System maintains records and accounts, and prepares financial statements using fund accounting principles and the accrual basis of accounting, under which benefits and expenses are recognized when due and payable and revenues are recorded in the accounting period in which they are earned and become measurable in accordance with the terms of the System.

For financial reporting purposes, TERS adheres to accounting principles that are generally accepted in the United States of America. The System applies all applicable pronouncements of the Governmental Accounting Standards Board (GASB).

GASB Statement No. 67, *Financial Reporting for Pensions*, addresses accounting and financial reporting requirements for pension plans. Significant requirements include an actuarial calculation of total and net pension liability. It also includes comprehensive footnote disclosure regarding the pension liability, the sensitivity of the net pension liability to the discount rate, and increased investment activity disclosures. The total pension liability, determined in accordance with GASB Statement No. 67, is presented in Note 2 and in the Required Supplementary Information.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and reporting issues related to fair value measurements. This Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. Comprehensive footnote disclosure regarding this Statement is found in Note 1 (d).

GASB Statement No. 82, *Pension Issues*, has been adopted during the year ended December 31, 2017. This Statement requires the presentation of "covered payroll" as pensionable payroll. Statement No. 82 also clarifies that payments made by employers to satisfy "plan member contribution requirements" should be classified as "plan member contributions". The commonly known practice "pick-up", which means that the employer pays the employee portion of the contribution does not apply to TERS because plan members have always paid the employee required contributions, not the employer. There has been a long standing practice that TERS member contributes 46% of the contribution rate, while the employer allocates 54%.

(c) Administrative Expenses

The Tacoma City Council, with the recommendation from the Board, adopts the operating budget for the administration of the System each biennium. The administrative expenses are financed from contributions and investment earnings of the System. The operating budget may include allocations for capital assets, which are capitalized upon purchase and expensed over their useful lives.

(d) Investments

Investment policy: The System's policy in regard to the allocation of invested assets is established and may be amended by the Board. TERS' assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully funded status for the benefits provided through the System. The following was the TERS actual asset allocation as of December 31, 2017:

Asset Class	Actual Allocation
Global equity	35.6 %
Low volatility equity	8.6
Core fixed income	14.6
TIPS	4.3
High yield / bank loans	8.6
Emerging markets debt	5.4
Real estate	8.1
Private equity	9.7
Real assets	4.9
Short term fund	0.2
Total	<u>100.0 %</u>

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

Equity securities, fixed income securities, private equity, real estate, and short-term investments are all reported on a trade date basis, at fair value. Fair value for public market managers was determined by the custodian bank utilizing standard industry practices. Private investments are reported by the managers subject to their fair value policies. No investment in any one corporation exceeded 5% of net position available for benefits.

(e) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from the estimated amount.

NOTE 2 FAIR VALUE MEASUREMENT

The System categorizes the fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The categorization of investments within the hierarchy is based upon the valuation transparency of the instrument as of the measurement date.

Level 1: Investments classified as Level 1 are based on unadjusted quoted prices in active markets for identical assets at the end of each reporting period.

Level 2: Investments classified as Level 2 are based on identical publicly traded securities and exchange-traded securities traded in inactive markets, quoted prices for similar instruments in active markets, or model-derived valuations in which all significant inputs are observable.

Level 3: Investments classified as Level 3 are primarily composed of investments whose valuations are derived from valuation techniques in which significant inputs are unobservable and require judgment and estimation.

Net Asset Value (NAV): The fair values of investments that are measured at fair value using NAV as a practical expedient are not classified in the fair value hierarchy.

The assessment of the significance of particular inputs to these fair value measurements requires consideration be given to factors specific to each asset or liability.

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments, which include money market-type securities, foreign currencies and short-term investment funds. The short-term investment funds are valued at cost plus accrued interest, which approximates fair value. Accordingly, these investments are excluded from the fair value schedule.

The table below presents the fair value measurements within the hierarchy established by generally accepted accounting principles as of December 31, 2017 for the Tacoma Employees' Retirement System.

Investments Measured at Fair Value Level As of December 31, 2017	Fair Value	Inputs		
		Level 1	Level 2	Level 3
Asset Backed Securities	\$ 20,243,776		\$ 20,243,776	
Commercial Mortgage Backed	3,527,483		3,527,483	
Common Stock	434,549,736	425,909,785	8,633,404	6,547
Corporate Bonds	200,559,362		200,559,362	
Government Agencies	74,193,049		74,193,049	
Government Bonds	56,749,411		56,749,411	
Government Mortgage Backed Securities	63,048,798		63,048,798	
Gov't-Issued Commercial Mortgage Backed	1,220,832		1,220,832	
Index Linked Government Bonds	8,336,473		8,336,473	
Municipal/Provincial Bonds	1,342,989		1,342,989	
Non-Government Backed C.M.O.S	7,035,635		7,035,635	
Total investments by fair value level	\$ 870,807,544	\$ 425,909,785	\$ 444,891,212	\$ 6,547

NOTE 2 FAIR VALUE MEASUREMENT continued

The table below presents the fair value measurements using NAV as of December 31, 2017 for the Tacoma Employees' Retirement System.

Investments Measured at the NAV* As of December 31, 2017	Fair Value	Unfunded Commitment	Redemption Frequency (If Currently Eligible)	Redemption Notification Period
Common Stock ⁽¹⁾	\$ 511,343,137	n/a	Daily, Monthly	Two to five business days
Fixed Income ⁽²⁾	140,095,565	n/a	Monthly	30 to 90 days
Private Equity ⁽³⁾	134,142,757	175,563,674	Illiquid	n/a
Real Estate ⁽⁴⁾	70,970,834	n/a	Quarterly, subject to market conditions	45 days prior to quarter- end
Total investments measured at the NAV	\$ 856,552,293	\$ 175,563,674		

Reconciliation to statement of fiduciary net position

Total investments by fair value level	\$ 870,807,544
Total investments measured at the NAV	856,552,293
Investments per statement of fiduciary net position	<u>\$ 1,727,359,837</u>

* In accordance with GASB 72, certain investments that were measured at NAV per share (or its equivalent) may not be classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented in the statement of net position.

(1) Common Stock

Assets are held in limited liability companies or trusts with daily or monthly liquidity and a perpetual life.

(2) Fixed Income

Assets are held in limited liability companies and trusts with monthly liquidity and a perpetual life.

(3) Private Equity

Assets are held in limited partnerships with constrained liquidity and anticipated life of seven to ten years.

(4) Real Estate

Assets are held in a limited partnership with quarterly liquidity and a perpetual life.

NOTE 3 DEPOSIT AND INVESTMENT RISK DISCLOSURES

(a) Custodial Credit Risk – Cash and Investments

Custodial credit risk is the risk that in the event of the failure of a financial institution or a bank, the System will not be able to recover the value of its deposits or investments that are in the possession of an outside party. Cash and short term investments include securities with a maturity date of three months or less.

Cash balances represent both operating cash accounts held by the City Treasurer and investment cash on deposit with the investment custodian, The Northern Trust Company (Northern). Cash held by the City Treasurer is invested in accordance with the City of Tacoma's investment policy; cash invested with Northern is under the custody agreement which holds Northern responsible for the safekeeping of all securities and funds held on behalf of the System. All the remaining City securities are held by the City's third party custodial bank in the City's name. The investments of the System are invested in accordance with the "prudent person rule".

The System mitigates its custodial credit risk by having its investment securities held by the System's custodian (Northern) with the investments registered in the System's name. Also, in accordance with the System's Investment Policy Statement, each of the System's investment managers is provided with a set of investment guidelines. These guidelines specify eligible investments, minimum diversification standards and applicable investment restrictions necessary for diversification and risk control. Managers do not have the authority to depart from their guidelines.

As of December 31, 2017, 100% of the System's cash and investments were held in the System's name and, therefore, the System has no custodial credit risk exposure.

(b) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's exposure in a single issuer. This disclosure requirement does not apply to investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments. The System does not have any investments from a single issuer (excluding pooled investments or explicitly guaranteed governments) that represent more than 5% of the System's assets. In accordance with the System's Investment Policy Statement, credit risk is mitigated by agreeing to a set of investment guidelines with the investment manager. These guidelines specify eligible investments, minimum diversification standards and applicable investment restrictions necessary for diversification and risk control. Managers do not have the authority to depart from their guidelines.

(c) Credit Risk

Credit risk is the financial risk that an issuer or other counterparty will not fulfill its obligation to TERS. Each of the fixed income investment managers consistently monitor the risk associated with their portfolios. The System does not have a formal policy to limit credit risk. However, the firms/funds adhere to investment guidelines that have been reviewed by TERS staff, and regularly report on their positions relative to the benchmark.

NOTE 3 DEPOSIT AND INVESTMENT RISK DISCLOSURES continued

The table below discloses the credit ratings for the System's investments in debt securities using Standard and Poor's credit ratings.

Quality Ratings	Fair Value
AAA	\$ 212,915,732
AA	47,333,388
A	22,255,025
BBB	43,041,260
BB	207,620,692
B	40,684,681
CCC	2,502,597
Total fixed income securities	<u>\$ 576,353,374</u>

(d) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates over time will adversely affect the fair value of an investment. Market or interest rate risk is one of the greatest risks faced by an investor in the debt securities market. The price of a debt security typically moves in the opposite direction of the change in interest rates. The interest rate risk is mitigated by providing each investment manager with a set of investment guidelines. These guidelines specify eligible investments, minimum diversification standards and applicable investment restrictions necessary for diversification and risk control. Managers do not have the authority to depart from their guidelines. Weighted average maturity is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates.

As of December 31, 2017, the System had the following debt investments:

Investment Type	Fair Value December 31, 2017	Weighted Average Maturity
Asset backed securities	\$ 20,243,776	32.08
Commercial mortgage backed	3,527,483	19.78
Corporate bonds	200,559,363	7.99
Government agencies	74,193,049	8.26
Government bonds	56,749,411	6.20
Government mortgage backed securities	63,048,798	18.36
Gov't-issued commercial mortgage backed	1,220,832	6.74
Index linked government bonds	8,336,473	8.73
Municipal/provincial bonds	1,342,989	17.30
Non-government backed C.M.O.S	7,035,635	18.83
Other fixed income	140,095,565	4.18
Total fixed income securities	<u>\$ 576,353,374</u>	

NOTE 3 DEPOSIT AND INVESTMENT RISK DISCLOSURES continued

(e) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely impact the fair value of an investment or deposit. The System does not have a formal policy to limit foreign currency risk. TERS manages their exposure to fair value loss by requiring their international securities investment managers to maintain diversified portfolios to limit foreign currency and security risk. The System's currency risk exposures, or exchange rate risks, primarily reside within the venture capital and partnerships investment holdings.

The table below represents securities held in a foreign currency as of December 31, 2017.

Currency Name	Cash and Cash Equivalents	Equities	Venture Capital and Partnerships	Total Fair Value
Australian dollar	\$ 20	\$ 1,535		\$ 1,555
Euro	77,256		6,833,762	6,911,018
New Israeli shekel	2,880			2,880
Total	<u>\$ 80,156</u>	<u>\$ 1,535</u>	<u>\$ 6,833,762</u>	<u>\$ 6,915,453</u>

NOTE 4 DERIVATIVES

Derivative instruments are financial contracts whose value depends on the values of underlying assets, reference rates, or financial indexes. They include futures contracts, swap contracts, credit-linked notes and forward foreign currency exchange. As of December 31, 2017, the derivative instruments held by the System are considered investments and not hedges for accounting purposes. The gains and losses arising from this activity are recognized in the Statement of Changes in Plan Net Position.

The System's investment managers, as permitted by their specific investment guidelines and consistent with the System's Investment Policy Statement, may enter into transactions involving derivative financial instruments. These instruments include futures, options, swaps, forwards, warrants and rights. By Board policy, these investments may not be used to leverage the System's portfolio, i.e., use derivatives to increase the portfolio's notional exposure to any given asset class. These instruments are used in an attempt to enhance the portfolio's performance and/or reduce the portfolio's risk. All investment derivatives discussed below are addressed in the Portfolio Risk discussion, which precedes this section. Investment derivative instruments are disclosed separately to provide a comprehensive and distinct view of this activity and its impact on the overall investment portfolio.

The table below provides a summary of the derivative instruments outstanding as of December 31, 2017.

Classification	Fair Value	Changes in Fair Value	Notional Fair Value
Forwards	\$ (1,575,780)	\$ (1,575,780)	
Futures			\$ 22,966,297
Total	<u>\$ (1,575,780)</u>	<u>\$ (1,575,780)</u>	<u>\$ 22,966,297</u>

The derivative instruments that are not exchange traded, such as credit default swaps and interest rate swaps, are valued using quoted market prices.

NOTE 4 DERIVATIVES continued

Credit default swaps (CDS) are contracts and agreements in which the protection buyer of the CDS makes a series of payments to the protection seller and, in exchange, receives a payoff if a credit instrument (typically a bond or loan) experiences a credit event.

Futures contracts are financial instruments that derive their value from underlying indices or reference rates and are marked-to-market at the end of each trading day. Daily settlement of gains and losses occur on the following business day. Daily settlement of gains and losses is a risk control measure to limit counterparty credit risk. Futures variation margin amounts are settled each trading day and recognized in the financial statements under net appreciation (depreciation) in fair value of investments as they are incurred.

An option is a contract that gives the buyer the right, but not the obligation, to buy or sell an underlying asset at a specific price on or before a certain date.

Rights/warrants are issued by corporations and provide the holder with the right, but not the obligation, to buy a company's common stock at a predetermined price - the subscription price. The right is good until its expiration date, which is usually four to six weeks after its issue.

Foreign currency forward contracts are obligations to buy or sell a currency at a specified exchange rate and quantity on a specific future date. The fair value of the foreign currency forwards is the unrealized gain or loss calculated based on the difference between the specified exchange rate and the closing exchange rate at December 31, 2017.

(a) Derivative Custodial Credit Risk

The custodial credit risk disclosure for exchange traded derivative instruments is made in accordance with the custodial credit risk disclosure requirements of GASB Statement 40, *Deposit and Investment Risk Disclosures*. At December 31, 2017, all of the System's investments in derivative instruments were held in the System's name and were not exposed to custodial credit risk.

(b) Derivative Interest Rate Risk

At December 31, 2017, the System was exposed to interest rate risk on its derivative investments. The table below illustrates the maturity periods of these derivative instruments.

Classification	Investment Maturities 3 months or less
Forwards	\$ (1,575,780)

(c) Derivative Contingent Features

As of December 31, 2017, the System did not hold any positions in derivatives containing contingent features.

NOTE 4 DERIVATIVES continued

(d) Derivative Foreign Currency Risk

At December 31, 2017, the System was exposed to foreign currency risk on its derivative investments, as shown in the table below:

Currency Name	Forwards
Australian dollar	\$ (134,677)
British pound sterling	(239,105)
Canadian dollar	(185,404)
Danish krone	(26,057)
Euro	(503,242)
Hong Kong dollar	(2,597)
Japanese yen	(199,515)
New Israeli shekel	(1,957)
New Zealand dollar	(2,992)
Norwegian krone	(19,159)
Singapore dollar	(10,202)
Swedish krona	(96,566)
Swiss franc	(154,308)
Total	<u>\$ (1,575,780)</u>

NOTE 5 SECURITIES LENDING

In accordance with the policies of the Board of Administration, the System lends its securities (i.e., U.S. Treasury bonds, U.S. equities and corporate bonds) to broker-dealers with an agreement to return in the future the collateral received for the securities. The System's Custodian (Northern) is authorized to lend available securities to authorized broker-dealers subject to the receipt of acceptable collateral. The System accepts collateral in the form of cash and U.S. government and agencies securities.

The System does not have the ability to pledge or sell non-cash collateral unless the borrower defaults. All securities loaned can be terminated on demand by either the lender or the borrower.

The Custodian provides for full indemnification to the System for any losses that might occur in the Securities Lending program due to the failure of a broker to return a borrowed security (and if the collateral is inadequate to replace the lent securities) or failure to pay the System for income from the securities while on loan. Additionally, the Custodian's responsibilities include performing appropriate borrower and collateral investment credit analyses, demanding adequate types of collateral, and complying with applicable regulations concerning securities lending.

Gross securities lending income during 2017 was \$760,005 and security lending agent fees and rebates were \$571,366, resulting in net security lending income of \$188,639. The fair value of loaned securities collateralized by cash collateral at December 31, 2017 was \$41,062,950; the cash collateral received from borrowers at December 31, 2017 was \$41,989,985.

Cash collateral is invested in a short-term investment pool. Cash collateral may also be invested separately in "term loans" in which case the investments match the loan term. These loans can be terminated on demand by either lender or borrower.

There were no violations of legal or contractual provisions or borrower or lending agent default losses known to the securities lending agent.

NOTE 6 PENSION VALUATION

As a result of Governmental Accounting Standard Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans*, and 68, *Accounting and Financial Reporting for Pensions*, TERS has separate valuations performed for financial reporting and funding purposes.

(a) Pension System Funding Valuations

The purpose of the actuarial valuation is to determine whether the scheduled contributions in combination with the future net investment earnings, and invested assets are projected to be sufficient to finance future member benefits.

An actuarial valuation of the System's assets and liabilities is performed annually. The January 1, 2018 actuarial funded ratio, which represents the ratio of the Actuarial Value of Assets (AVA) to the Actuarial Accrued Liability (AAL), was 99.2%, up from 96.2% from the January 1, 2017 valuation. This is based on the AVA as of December 31, 2017, which uses smoothing on gains and losses of investments over four years. Based on the Fair Value of Assets (FVA), the System's funded ratio was 102.5% from January 1, 2018 in comparison with 93.9% from January 1, 2017 valuation.

(b) Financial Reporting Valuation

The actuarial valuation for financial reporting emphasizes the obligation an employer incurs to pay for the benefit, as promised. The primary purpose of the valuation for financial reporting is to provide a consistent, standardized methodology that allows comparability of data and increased transparency of the pension liability across plans. To do so, GASB requires a different approach for determining the reported Net Pension Liability or Asset (NPL or NPA), as compared to the previously disclosed Unfunded Actuarial Accrued Liability (UAAL). The UAAL mirrored the Unfunded Actuarial Accrued Obligation calculated by TERS' external actuary for funding purposes and represented the excess of the Actuarial Accrued Liability (AAL) over the Actuarial Value of Assets (AVA). Under GASB 67, the UAAL has been replaced by the NPL, which represents the excess of the Total Pension Liability (TPL) over fiduciary net position.

There are considerable differences between the UAAL and the NPL. Conceptually, the UAAL is the actuary's measure of the additional amount of assets needed to pay all benefits earned to date by current plan members, while the NPL is an accrual calculation that reflects future benefits earned by plan members in excess of the System's fiduciary net position.

Per the Board's decision, the System is reporting an Actuarially Determined Contribution (ADC). The ADC for the period ended December 31, 2016 is based on a 30-year amortization of the UAAL based on the AVA, or the current employer contribution rate if that is greater. In July 2016, the Board changed the ADC to be based on a 25-year amortization of UAAL. This was reflected in the January 1, 2017 actuarial valuation, which will be used to calculate the ADC for the year beginning January 1, 2018 reporting date for the employer.

TERS has NPA and, therefore, did not have to calculate a blended rate of return. Instead, TERS discounted all future obligations using the long-term expected rate of return on plan assets, which is currently 7.0%. This rate is net of investment expenses and gross of administrative expenses. Based on that assumption, TERS has NPA of \$42.5 million as of December 31, 2017.

NOTE 7 NET PENSION LIABILITY OR ASSET OF EMPLOYERS

The Net Pension Liability or Asset (NPL or NPA) (i.e., the System's liability is determined in accordance with GASB No. 67, *Financial Reporting for Pension Plans*, less the fiduciary net position) as of December 31, 2017, is shown below.

Net Pension Liability (Asset)	2017
Total pension liability	\$ 1,680,719,624
Fiduciary net position	1,723,249,522
Net pension liability	<u>\$ (42,529,898)</u>
Fiduciary net position as of % of total pension liability	102.53%
Covered payroll	\$ 241,586,398
Net pension liability as a percentage of covered payroll	-17.60%

Actuarial valuation of the System involves estimates of the reported amounts and assumptions about probability of occurrence of events far into the future. For example, assumptions about future employment, mortality and future salary increases. Amounts determined regarding the net pension liability or asset are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The last Experience Study was performed in 2016 and the next Experience Study is scheduled to be conducted in 2020. The Schedule of Employers' Net Pension Liability or Asset presents multi-year trend information about whether the plan fiduciary net position is increasing or decreasing over time relative to the total pension liability. These schedules are presented in the Required Supplementary Information section. The Total Pension Liability as of December 31, 2017, is based on the results of an actuarial valuation date as of January 1, 2018 using the generally accepted actuarial procedures.

NOTE 7 NET PENSION LIABILITY OR ASSET OF EMPLOYERS continued

(a) Actuarial Assumptions

A summary of the actuarial assumptions used for funding and GASB 67, *Financial Reporting for Pension Plans*, reporting valuation in the latest actuarial valuation is shown below.

Valuation Date	January 1, 2018
Actuarial Cost Method	Entry Age Normal
Amortization Method	Funding is based on statutory contribution rate. This amount is compared to a 30-year amortization for the purposes of calculating the Actuarially Determined Contribution. The amortization method for the ADC is as follows*:
Level percent or level dollar:	Level percent
Closed, open, or layered periods:	Open
Amortization period:	25 years*
Amortization growth rate:	3.75%
Asset Valuation Method	
Smoothing period:	4 years
Corridor:	None
Inflation	2.75%
Salary Increases	Varies by service; details in funding valuation report.
Investment Rate of Return	7.00%
Cost of Living Adjustments	2.125%
Retirement Age	Varies by age, gender, eligibility; details in funding valuation report.
Turnover	Varies by service, gender; details in funding valuation report.
Mortality	RP- 2014 Mortality for Employees, Healthy and Disabled Annuitants. Generational improvements with projection scale based on Social Security Administration Data
Active Members:	RP-2014 Employee Mortality, sex-distinct. RP-2014 50% Blue Collar/50% White Collar
Male Inactive Members and Male Beneficiaries:	Mortality for Healthy Males, RP-2014 Disabled Mortality for males.
Female Inactive and Female Beneficiaries:	RP-2014 Blue Collar Mortality for Healthy Females, RP-2014 Disabled Mortality for females.

* The actual contribution is used if that rate is greater than the rate necessary to amortize the UAAL. Note that the UAAL amortization period is 30 years for years 2017 and earlier and 25 for years beginning January 1, 2018 and later.

NOTE 7 NET PENSION LIABILITY OR ASSET OF EMPLOYERS continued

(b) Target Allocations

The long-term expected rate of return is determined by adding expected inflation to expected long-term real returns and reflecting volatility and correlation. The capital market assumptions are per Milliman's (the System's actuary) investment consulting practice as of December 31, 2017. The target asset allocation is based on TERS Investment Policy Statement dated March 2016.

Asset Class	Target Allocation	Long-Term Expected Arithmetic Real Rate of Return
Investment grade fixed income	15.0 %	2.06 %
US inflation-indexed bonds	5.0	1.36
High yield bonds	9.0	4.69
Emerging market debt	5.0	3.39
Global equity	41.5	4.95
Public real estate	2.0	5.55
Private real estate	2.5	3.83
Private equity	10.0	8.88
Master limited partnerships	4.0	4.20
Timber	2.0	4.04
Infrastructure	2.0	4.89
Agriculture	2.0	4.54
Assumed inflation- mean		2.75
Assumed inflation- standard deviation		1.85
Portfolio arithmetic real mean return		4.56
Portfolio median nominal geometric return		6.68
Portfolio standard deviation		11.77
Long-term expected rate of return, net of investment expenses		7.00

(c) Sensitivity Analysis

The following presents the NPL of the plan, calculated using the discount rate of 7.00%, as well as what the System's NPL would be if it were calculated using a discount rate that is 1 percentage point lower (6.00%) or 1 percentage point higher (8.00%) than the current rate.

	1% Decrease 6%	Current Discount Rate 7%	1% Increase 8%
Total pension liability	\$ 1,896,168,463	\$ 1,680,719,624	\$ 1,500,682,402
Fiduciary net position	1,723,249,522	1,723,249,522	1,723,249,522
Net pension liability (asset)	<u>\$ 172,918,941</u>	<u>\$ (42,529,898)</u>	<u>\$ (222,567,120)</u>

NOTE 8 OTHER POSTEMPLOYMENT BENEFITS (OPEB)

The System does not have any OPEB related costs for the year ending December 31, 2017. The City of Tacoma reports OPEB information related to TERS members in its financial reporting.

NOTE 9 OTHER MATTERS

No investments were made in loans to, or leases with, any Tacoma Employees' Retirement System official, governmental employer official, party related to a Tacoma Employees' Retirement System official or governmental employer official, non-employer contributor, or organization included in the reporting entity of our participating employers.

The Board of Administration of the Tacoma Employees' Retirement System administers the System. Any risk of loss would be based upon how the System was administered and would be covered through a fiduciary liability policy for the Board or would be paid from plan resources.

There were no significant subsequent events requiring further disclosure. There were no material violations of financial related legal and contractual provisions.

Required Supplementary Information

1. Schedule of Changes in Net Pension Liability or Asset of Employers and Related Ratios

Total Pension Liability	2017	2016	2015	2014
Service cost	\$ 40,301,955	\$ 42,533,534	\$ 39,962,780	\$ 38,484,316
Interest on total pension liability	115,522,246	115,288,127	105,422,784	100,571,822
Effect of plan changes	(36,833,135)	-	-	-
Effect of economical/demographic gains or losses	(8,898,349)	(20,746,776)	(2,708,626)	(6,285,151)
Effect of assumptions changes or inputs	-	40,767,283	-	-
Benefit payments/refunds of contributions	(77,467,644)	(71,996,054)	(68,607,774)	(64,636,634)
Net change in total pension liability	32,625,073	105,846,114	74,069,164	68,134,353
Total pension liability, beginning	1,648,094,551	1,542,248,437	1,468,179,273	1,400,044,920
Total pension liability, ending (a)	1,680,719,624	1,648,094,551	1,542,248,437	1,468,179,273
Fiduciary Net Position				
Employer contributions	26,091,331	25,536,034	24,557,390	23,903,892
Member contributions	23,008,946	22,407,327	21,258,474	20,698,886
Investment income net of investment expenses	205,616,277	124,939,177	(5,292,224)	111,425,834
Benefit payments/refunds of contributions	(77,467,644)	(71,996,054)	(68,607,774)	(64,636,634)
Administrative expenses	(1,663,105)	(1,917,955)	(1,691,339)	(1,716,124)
Net change in plan fiduciary net position	175,585,805	98,968,529	(29,775,473)	89,675,854
Fiduciary net position, beginning	1,547,663,717	1,448,695,188	1,478,546,808	1,388,670,954
Fiduciary net position, ending (b)	1,723,249,522	1,547,663,717	1,448,771,335	1,478,546,808
Net position liability (asset), ending = (a) - (b)	(42,529,898)	100,430,834	93,477,102	(10,367,535)
Fiduciary net position as a percentage of total pension liability	102.53%	93.91%	93.94%	100.71%
Covered payroll	241,586,398	236,444,759	227,383,241	221,332,333
Net pension liability as a percentage of covered payroll	-17.60%	42.48%	41.11%	-4.68%

Note: This schedule is to be built prospectively until it contains ten years of data

2. Schedule of Net Pension Liability or Asset of Employers

The System's fiduciary net position, along with the expected future contributions, was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the discount rate for calculating the total pension liability is equal to the long-term expected rate of return of 7.25% in 2014 through 2016 and 7.00% in 2017 and in future years.

(All Amounts in millions)

Net Pension Liability (Asset)	2017	2016	2015	2014	2013
Total pension liability	\$ 1,680.7	\$ 1,648.1	\$ 1,542.2	\$ 1,468.2	\$ 1,400.0
Fiduciary net position	1,723.2	1,547.7	1,448.8	1,478.5	1,388.9
Net pension liability	\$ (42.53)	\$ 100.43	\$ 93.48	\$ (10.37)	\$ 11.17
Fiduciary net position as a percentage of total pension liability	102.53%	93.91%	93.94%	100.71%	99.20%
Covered payroll	2,416	2,364	2,274	2,213	2,138
Net pension liability as a percentage of covered payroll	-17.60%	42.48%	41.11%	-4.68%	5.23%

Note: This schedule is to be built prospectively until it contains ten years of data.

3. Schedule of Employers' Contributions

In April 2014, the Board adopted an ADC. The ADC for the period ended December 31, 2016 is based on a 30-year amortization of the UAAL based on the AVA, or the current employer contribution rate if that is greater. At the July 2016 Board meeting, the Board changed the ADC to be based on a 25-year amortization of the UAAL. This was reflected in the January 1, 2017 actuarial valuation, which will be used to calculate the ADC for the year beginning January 1, 2018.

Fiscal Year Ending December 31	Actuarially Determined Contribution*	Actual Employer Contribution	Contribution Deficiency (Excess)	Covered Payroll**	Employer Contribution as a % of Covered Payroll
2008	\$ 14,900,000	\$ 14,900,000	-	\$ 197,400,000	7.56 %
2009	17,900,000	17,900,000	-	209,900,000	8.55
2010	21,300,000	21,300,000	-	219,600,000	9.72
2011	22,500,000	22,500,000	-	219,400,000	10.26
2012	22,700,000	22,700,000	-	210,600,000	10.80
2013	23,600,000	23,100,000	500,000	213,800,000	10.80
2014	26,100,000	23,900,000	2,200,000	221,300,000	10.80
2015	27,800,000	24,600,000	3,200,000	227,400,000	10.80
2016	26,500,000	25,500,000	1,000,000	236,400,000	10.80
2017	26,100,000	26,100,000	-	241,600,000	10.80

*The 20% contribution rate, which is split 10.80% paid by the employer and 9.20% by the member, is consistent with the goal of being greater than or equal to the normal cost rate.

**Covered payroll listed is pensionable payroll.

4. Schedule of Contribution Rates

Per the Tacoma Municipal Code sections 1.30.350 and 1.30.360, the current contribution rate is 20.00%, split 10.80% to the employer and 9.20% to the member. Contributions made by the employers and the members were in accordance with actuarially computed funding requirements. The following chart shows the history of the contribution rates since 1980.

Applicable Period	Rate as % of Payroll		
	Employer	Employee	Total Rate
1/1/1980 to 12/31/1996	10.44 %	8.89 %	19.33 %
1/1/1997 to 12/31/2000	9.02	7.68	16.70
1/1/2001 to 1/31/2009	7.56	6.44	14.00
2/1/2009 to 12/31/2009	8.64	7.36	16.00
1/1/2010 to 12/31/2010	9.72	8.28	18.00
1/1/2011 to 12/31/2011	10.26	8.74	19.00
1/1/2012 to 1/31/2018	10.80	9.20	20.00
2/1/2018 onward	11.34	9.66	21.00

5. Schedule of Investment Returns

The following is the schedule of the System's annual money-weighted rate of return. The performance calculations were prepared by Wilshire Consulting using the internal rate of return, net of investment expenses and adjusted for the changing amounts actually invested.

2017	2016	2015	2014	2013	2012	2011	2010	2009	2008
Percentage									
14.34	9.25	(0.67)	8.33	17.25	15.17	0.75	15.38	29.52	(34.50)

Notes to Required Supplementary Information

1. Schedule of Net Pension Liability or Asset of Employers

The total pension liability contained in this schedule was provided by the System's actuary, Milliman. The net pension liability or asset is measured as the total pension liability less the amount of the System's fiduciary net position. The System's fiduciary net position, along with the expected future contributions, was projected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the discount rate for calculating the total pension liability is equal to the long-term expected rate of return of 7.25% in 2014 through 2016 and 7.00% in 2017 and in future years.

2. Schedule of Employers' Contributions

The required employers' contributions and percent of those contributions actually made are presented in the schedule.

3. Actuarial Assumptions

The information presented in the required supplementary schedules was used in the actuarial valuation for purposes of determining the actuarially determined contribution rate. The assumptions and methods used for this actuarial valuation were recommended by the actuary and adopted by the Board.

Other Supplementary Information

1. Schedule of Administrative Expenses
For the Year Ended December 31, 2017 and 2016

	2017	2016
Personnel services		
Salaries and wages	\$ 597,352	\$ 582,658
Personnel benefits	236,511	246,478
Total personnel services	<u>\$ 833,863</u>	<u>\$ 829,136</u>
 Maintenance and operations		
Communications	\$ 21,975	\$ 27,155
General government allocation	95,699	144,811
Information technology	126,931	92,867
Insurance	58,198	56,405
Miscellaneous	4,119	9,126
Office supplies and expenses	19,858	23,723
Professional services	412,423	649,893
Rentals	79,272	75,690
Travel and training	10,766	9,150
Total maintenance and operation	<u>\$ 829,242</u>	<u>\$ 1,088,819</u>
 Total administrative expenses *	<u><u>\$ 1,663,105</u></u>	<u><u>\$ 1,917,955</u></u>

* Does not include investment management expenses.

2. Schedule of Payments to Consultants

For the Year Ended December 31, 2017

Type	Amount
Custodial bank services	
The Northern Trust Company	\$ 41,897
Actuarial services	
Milliman Consultants and Actuaries	142,499
Pension and investment consulting services	
Wilshire Associates	198,500
Other services (type)	
Davis Wright Tremaine, LLP & Others (Legal)	3,858
Investment Advisory Committee (Citizen Advisory)	1,100
Independent Medical Consultants (Disability Evaluation)	9,115
Small World Solutions (Death Audit)	800
Washington State Auditor's Office (Financial Audit)	14,654
	<u>29,527</u>
Total consultant fees*	<u><u>\$ 412,423</u></u>

* Does not include investment management expenses.

Information regarding investment management fees can be found on [page 3-9](#) of the Investment Section.

3. Schedule of Investment Expenses

For the Year Ended December 31, 2017

Type	Amount
Investment management fees	\$ 6,275,625
Securities lending fees*	571,366
Total investment expenses	\$ 6,846,991

* Securities lending fees include broker rebates and the lending agent's fees.

Information regarding investment management fees can be found on [page 3-9](#) of the Investment Section.

4. Schedule of Proportionate Share by Employer

TERS is a cost-sharing multiple employer plan. The System's actuary had calculated the pension expense for 2017, NPL and deferred outflows/inflows of resources as of December 31, 2017. These accounting metrics must be allocated to the various participating employers. The allocation method relies on a determination of a proportion attributable to each employer. This proportion is then applied to the relevant aggregate plan figures to determine the proportionate share of the pension expense, NPL and deferred outflows/inflows of resources each employer must recognize. GASB 68, *Accounting and Financial Reporting for Pensions*, requires that the proportion share for each employer must be consistent with the determination of the plan contributions. The standard encourages the use of the "projected long-term contribution effort" of each employer to the plan. Because each employer in TERS contributes at the same rate of payroll, using the actual contributions for the year provides a reasonable basis for each employer's projected long-term contribution effort.

Employer	Proportionate Share		Net Pension Liability		Deferred Outflows of Resources				Deferred Inflows of Resources				Pension Expense			
	2017 Employer Contributions	Rounded Percentage of Total Contributions	Beginning Net Pension Liability*	Ending Net Pension Liability **	Differences Between Expected and Actual Experience	Changes in Assumptions	Net Difference Between Projected and Actual Investment Earnings	Changes in Employer Proportion	Differences Between Expected and Actual Experience	Changes in Assumptions	Net Difference Between Projected and Actual Investment Earnings	Changes in Employer Proportion	Proportionate Share** of 2017 Collective Pension Expense	Net Amortization of Deferred Amounts from Changes in Proportion	Total Employer Pension Expense	
City of Tacoma	\$ 24,124,140	92.46037%	\$ 92,880,523	\$ (9,323,299)	\$ -	\$ 23,986,824	\$ -	\$ 27,878	\$ (21,789,842)	\$ -	\$ (45,123,372)	\$ (24,218)	\$ (12,020,353)	\$ 10,996	\$ (12,009,357)	
South Sound 911	22,953	0.08797%	136,405	(37,414)	-	22,822	-	677	(20,732)	-	(42,933)	(20,382)	(11,437)	(4,176)	(15,613)	
Pierce Transit	73,435	0.28145%	274,143	(119,702)	-	73,017	-	9,713	(66,329)	-	(137,358)	-	(36,591)	2,810	(33,781)	
TPCHD	1,870,803	7.17021%	7,139,763	(3,049,483)	-	1,860,154	-	35,476	(1,689,780)	-	(3,499,273)	(29,144)	(932,166)	(9,630)	(941,796)	
Grand Total	\$ 26,091,331	100.00000%	\$ 100,430,834	\$ (42,529,898)	\$ -	\$ 25,942,817	\$ -	\$ 73,744	\$ (23,566,683)	\$ -	\$ (48,802,936)	\$ (73,744)	\$ (13,000,547)	\$ -	\$ (13,000,547)	

*Based on unrounded contributions from 2016.

** Based on unrounded contributions from 2017.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as [fraud](#), state [whistleblower](#) and [citizen hotline](#) investigations.

The results of our work are widely distributed through a variety of reports, which are available on our [website](#) and through our free, electronic [subscription](#) service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

Contact information for the State Auditor's Office	
Public Records requests	PublicRecords@sao.wa.gov
Main telephone	(360) 902-0370
Toll-free Citizen Hotline	(866) 902-3900
Website	www.sao.wa.gov