# PASADENA FIRE AND POLICE RETIREMENT SYSTEM
# A PENSION TRUST FUND OF THE CITY OF
# PASADENA, CALIFORNIA

## REPORT AND AUDITED FINANCIAL STATEMENTS
## WITH REQUIRED SUPPLEMENTAL INFORMATION

## FOR THE YEAR ENDED JUNE 30, 2014 WITH COMPARATIVE TOTALS

**PASADENA FIRE AND POLICE RETIREMENT SYSTEM**
**FOR THE YEAR ENDED JUNE 30, 2014 WITH COMPARATIVE TOTALS**
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BROWN ARMSTRONG
Certified Public Accountants

# INDEPENDENT AUDITOR'S REPORT

To the Board of Retirement
Pasadena Fire and Police Retirement System
Pasadena, California

**Report on the Financial Statements**

We have audited the accompanying statement of fiduciary plan net position of Pasadena Fire and Police Retirement System (System), as of June 30, 2014, and the related statement of changes in fiduciary plan net position for the year then ended, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

**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*. 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 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 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 fiduciary plan net position of the System, as of June 30, 2014, and the respective changes in fiduciary plan net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 2 to the financial statements, during the year ended June 30, 2014, the System implemented Governmental Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans-an amendment of GASB Statement No. 25*. Our opinion is not modified with respect to this matter.

**Other Matters**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and required supplementary information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB, 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.

*Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The other supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The other supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such 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 supplementary information is fairly stated, in all material respects in relation to the basic financial statements.

*Report on Summarized Comparative Information*

We have previously audited the System's June 30, 2013 financial statements, and our report dated October 22, 2013, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2013, is consistent in all material respects, with the audited financial statements from which it was derived.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 6, 2014, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the 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 System's internal control over financial reporting and compliance.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
October 6, 2014

The Pasadena Fire and Police Retirement System ("System" or "Plan") is a defined benefit plan governed by a Board of Retirement ("Board") under the provisions of the City of Pasadena ("City") Charter. Its operations have been reported as a Pension Trust Fund in the City's financial statements. The System is a closed, single employer, defined benefit pension plan that provides retirement, disability, and survivor benefits for eligible sworn safety employees of the City. The System serves the City's sworn employees hired prior to July 1, 1977, except those who elected to transfer to the California Public Employees Retirement System ("CalPERS") either when the System was closed to new members, or in June 2004. The System is governed by a Board of five members; one member of the City Council, two Pasadena residents appointed by the City Council, and two members of the System elected under the supervision of the System. Board members are elected to terms of four years with no restriction on reappointment. Board members receive no compensation.

The discussion and analysis of the System's financial performance provides an overview of the financial activities for the fiscal year ending June 30, 2014. This discussion and analysis should be read in conjunction with and is qualified in its entirety by the accompanying audited financial statements and footnotes which begin following this Management Discussion and Analysis. The financial statements, footnotes, and this discussion and analysis were prepared by management and are the responsibility of management.

## Financial Highlights

The Plan ended fiscal year 2014 with $148,204,390 in fiduciary plan net position as of June 30, 2014, compared to $140,172,769 in net position restricted for employees' pension benefits on June 30, 2013. The increase in net position of $8,031,621 for fiscal year 2014 was attributed to net portfolio earnings outpacing total expenditures for benefits and administration. Earnings in the portfolio were 15.4% net of fees, and resulted in $21,303,965 in net investment income. Earnings were offset by $12,500,000 in withdrawals for benefits and administration. Investment income was consistent with overall market conditions, and outpaced the portfolio's benchmark earnings rate of 14.8%.

A cash reserve within pooled cash at the City was maintained to meet the required monthly cost of benefits and administration. Rebalancing serves as an ongoing process to maintain balance with the Board's asset allocation goals, and when necessary, to fund the Plan's benefit and administrative costs. During fiscal year 2014, a total of $12,500,000 was withdrawn from the portfolio with Northern Trust and transferred to the City's pooled cash account for payment of pension benefits and administration. The quarterly rebalance and withdrawal amounts for benefits and administrative expenses ranged from $2,000,000 to $3,750,000 per quarter.

The Fiduciary Net Position (FNP) increased from $140.2 million on June 30, 2013 to $148.2 million on June 30, 2014. Thus, the Net Pension Liability decreased from $28.6 million to $11.3 million, which increased the funded status from 83.1% on June 30, 2013 to 92.9% on June 30, 2014.

The contribution for fiscal year 2015 (due January 1, 2015) is anticipated to be $0 based on the June 30, 2014 actuarial valuation under Amended and Restated Contribution Agreement No. 20,823 (Agreement No. 20,823). Consistent with Agreement No. 20,823, a contribution in the amount of $1,164,000 was required from the City for fiscal year 2014.

Deductions from plan net position consisted of benefits payments to beneficiaries and the plan's administration costs. Total deductions were $14,436,344 in fiscal year 2014, which reflects a net decrease of $156,936 compared to the prior year. The net decrease in deductions was largely due to realized deaths of plan beneficiaries; thus, benefit payments decreased as the total number of beneficiaries decreased.

## Investment Performance Statement

The Board reviews the asset allocation in the Investment Policy Statement (IPS) on an annual basis, including a 10-year return forecast (both geometric and arithmetic) analysis by asset class. The forecasts per asset class are discussed within the context of their individual standard deviation forecasts, the amount of risk each asset assumes for the forecasted returns, and the relationship of that asset/risk within the overall portfolio. Portfolio mix options are discussed given the expected returns in comparison to the current allocations, and the investment advisor provides recommendations to the Board regarding potential changes in the asset allocation mix and for prospective new managers. In addition, fund and asset benchmarks are added and/or changed in the IPS to more accurately evaluate the portfolio and each asset's performance or when a new asset is acquired.

The System's IPS has evolved upon hiring a new investment advisor, Wurts Associates, in 2011. The June 2011 policy revision adjusted the strategic allocation ranges for equities and fixed income, added allocations to Treasury Inflation Protected Securities (TIPS) and Private Real Estate, and deleted the allocation to Real Estate Investment Trust (REIT). In June 2013 the policy was revised to add an allocation for Liquid Alternative Investments through adjusting the strategic allocation ranges in equities.

In recognition of a tighter earnings environment and towards the goal of reducing risk, the IPS was revised in May 2014 to create a new fixed income asset class for Senior Bank Loans. The policy target for the new asset class was established at 5.0%, and was created through equal reductions to the asset classes for Large Cap Domestic Equities, from 11.0% to 9.0% each, and by a 1.0% reduction to Small/Mid Cap Equity. The S&P/LSTA Leveraged Loan benchmark was added for this asset class in the IPS in May 2014.

**Portfolio Changes**

Upon Wurts Associates recommendation, the Board approved hiring Voya Investment Management (Voya) asset manager for the newly created space for Senior Bank Loan asset class. The System purchased $7,300,000 in Voya to meet the 5.0% asset allocation policy target on June 27, 2014. Funding for the Voya purchase was achieved through a rebalance of $2,850,000 from Dodge & Cox Stock Fund (Domestic Large Cap Value, 11.0% to 9.0% revised policy target), $2,950,000 from Vanguard Growth Index Fund (Domestic Large Cap Growth, 11.0% to 9.0% revised policy target), and $1,500,000 from Atlanta Capital (Small/Mid Cap, 5.0% to 4.0% revised policy target).

**Actuarial Valuation and City Contributions**

The System's funding objective is to meet long-term benefit promises by maintaining a well-funded plan status and obtaining optimum returns consistent with the assumptions of prudent risk. Funds are accumulated to meet these future obligations in the net position restricted for employees' pension benefits in the Statement of Fiduciary Plan Net Position in the Financial Section of this report. The total pension liability is not reported in the basic financial statements, but is disclosed in Note 5 to the basic financial statements and in the required supplementary information. The total pension liability is determined by the actuary and is a measure of the present value of actuarial accrued liabilities estimated to be payable in the future to current retirees and beneficiaries. The net pension liability is measured as the total pension liability less the amount of the pension plan's fiduciary net position. The System engaged Bartel Associates in July 2010 to serve as its independent actuary, and in January 2013 the Board approved a two-year extension of the contract for the preparation of the 2013 and 2014 actuarial valuations. The most recent actuarial valuation was prepared as of June 30, 2014, and incorporated the requirements to comply with GASB Statement No. 67, which the System implemented for the fiscal year ended June 30, 2014. A more complete discussion regarding the implementation of GASB Statement No. 67 is provided later in this section.

The June 30, 2014 valuation determined the Actuarial Value of Assets (AVA) funded percentage, calculated in accordance with Agreement No. 20,823 and Contribution Agreement No. 16,900, to be 81.6% as compared to 75.8% in the prior year.

The AVA funded percentage increased by 3.9% in 2014 over what was originally projected for the year (originally 77.7%). This AVA improvement was attributed to the following actuarial gains: the effect of recognizing a portion of the investment gains which increased the funded position by 1.6%; actual cost of living adjustment (COLA) that was less than projected and increased the funded position by 1.6%; demographic gains that increased the funded percentage by 0.7%; and lower than expected benefit payments attributable to more than expected deaths. As of June 30, 2014, the Plan had an approximate market value asset rate of return of 15.7% net of expenses (for actuarial purposes), compared to 11.6% in the previous year, and was above the assumed rate of return of 6.0%.

As provided by Contribution Agreement No. 16,900, if the AVA funded percentage is below the minimum funding percentage of 77.0% for fiscal year 2014, the City will reimburse the System in the following fiscal year subject to certain reimbursement limits. Based on the June 30, 2014 actuarial valuation, the funding deficiency was $0, or 0%, below the funding requirement of 77.0%. This compared to a funding deficiency of $1,131,000 or 0.67% to meet the minimum funding requirement of 76.5% as of June 30, 2013.

Overall, the Actuarial Accrued Liability decreased over what was expected, and the Actuarial Value of Assets increased over what was expected. A required supplemental contribution is not owed to the System for the fiscal year ended June 30, 2014.

## GASB Statement No. 67 Implementation

The System's financial statements, notes to the financial statements, and required supplementary information were prepared in accordance with the reporting requirements of GASB Statement No. 67. The most recent actuarial valuation as of June 30, 2014 used the Entry Age Normal Cost Method in the preparation of the valuation.

The Total Pension Liability for the plan at June 30, 2014 was $159,516,000, and the Fiduciary Net Position was $148,204,000. Thus, the Net Pension Liability for the plan was $11,312,000, and the Funded Status for the plan was 92.9%.

The Notes to Financial Statements provide additional disclosures to comply with GASB Statement No. 67 Implementation, as follows:

- Plan Membership
- Investments (allocation by asset class, expected long-term rate of return by asset class, and the annual money-weighted rate of return)
- Investments greater than 5% of the Plan's Fiduciary Net Position
- Net Pension Liability (and the components of Net Pension Liability)
- Significant actuarial assumptions used to measure Total Pension Liability

The Required Supplementary Information (RSI) section includes the following four schedules:

- 10-Year Schedule of Changes in Net Pension Liability
- 10-Year Schedule of Net Pension Liability
- 10-Year Schedule of Contractually Required Employer Contributions
- 10-Year Schedule of Annual Money-Weighted Rate of Investment Returns

The Supplementary Information section includes schedules detailing revenues by source and expenses by type.

## Plan Demographics

As of June 30, 2014 the plan had a total of 247 participants, compared to 257 as of June 30, 2013. The average age was 77.1 years and the average monthly benefit was $4,689. Since June 30, 2013, the Plan experienced 10 deaths without a beneficiary, six deaths with a beneficiary and six new beneficiaries for a net reduction of 10 participants.

## Financial Statement Overview

This discussion and analysis serves as an introduction to the System's basic financial statements. These include the following three components:

- Statement of Fiduciary Plan Net Position
- Statement of Changes in Fiduciary Plan Net Position
- Notes to Financial Statements

In addition to the financial statements, this report also contains required supplementary information and supporting schedules of actuarial information.

The *Statement of Fiduciary Plan Net Position* provides a snapshot of account balances at year-end. It also indicates the assets available for future benefit payments and administration of the Plan as well as current liabilities outstanding at year-end. The assets less liabilities give the reader a clear picture of what funds are available for future payments.

The *Statement of Changes in Fiduciary Plan Net Position,* in contrast, provides a summary view of the additions to and the deductions from the plan net position that occurred over the course of the year.

Together these two statements report the System's plan net position – the difference between assets and liabilities – as one way to measure the System's financial position. Over time, increases and decreases in plan net position are one indicator of whether the System's financial situation is improving or deteriorating. Additional factors, such as market conditions, also need to be considered in assessing the System's overall financial situation.

The financial statements and required disclosures are in compliance with the accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board, using the accrual basis of accounting. Investments are reported at current fair value. Both realized and unrealized investment gains and losses are recognized.

The *Notes to Financial Statements* provide additional information and explanations that are essential to a full understanding of the data provided in the financial statements.

The RSI follows the notes showing the Plan's net pension liability, as well as information reflecting how much the City has contributed in relation to its annual required contributions and other information to comply with GASB Statement No. 67. Refer to the RSI for additional information.

**Condensed Statement of Fiduciary Plan Net Position**

| | June 30, 2014 | June 30, 2013 | $ Change 2014/2013 | % Change |
|---|---|---|---|---|
| | (In Thousands) | | | |
| Current Assets | $ 8,977 | $ 14,056 | $ (5,079) | -36.13% |
| Investments | 145,619 | 140,238 | 5,381 | 3.84% |
| Total Assets | 154,596 | 154,294 | 302 | 0.20% |
| Total Liabilities | 6,392 | 14,121 | (7,729) | -54.73% |
| Total Fiduciary Plan Net Position | $ 148,204 | $ 140,173 | $ 8,031 | 5.73% |

As of June 30, 2014, the System had $148,204,390 in Plan net position. The net position represents funds restricted for employees' pension benefits. The total pension liability is not reported in the basic financial statements, but is disclosed in the notes and in RSI. Only current liabilities are reported on the Statement of Fiduciary Plan Net Position.

**Condensed Statement of Changes in Fiduciary Plan Net Position**

| | June 30, 2014 | June 30, 2013 | $ Change 2014/2013 | % Change |
|---|---|---|---|---|
| | (In Thousands) | | | |
| Employer Contributions | $ 1,164 | $ - | $ 1,164 | 100.00% |
| Net Investment Income | 20,783 | 15,630 | 5,153 | 32.97% |
| Other Income | 520 | - | 520 | 100.00% |
| Total Additions | 22,467 | 15,630 | 6,837 | 43.74% |
| Benefit Payments | 14,140 | 14,322 | (182) | -1.27% |
| Administrative Expenses | 296 | 271 | 25 | 9.23% |
| Total Deductions | 14,436 | 14,593 | (157) | -1.08% |
| Net Increase in Fiduciary Plan Net Position | $ 8,031 | $ 1,037 | $ 6,994 | 674.45% |

During the year ended June 30, 2014, the Plan's net position increased by $8,031,621 principally as a result of the earnings in the portfolio which outpaced total deductions.

**Fiduciary Responsibilities**

The System is a fiduciary for the pension plan of the City of Pasadena. Accordingly, the System is responsible for ensuring that the assets reported in the statements are used for the intended purpose of paying expenses and providing retirement benefits to the retirees and beneficiaries of the System.

**Requests for Information**

This financial report is designed to provide a general overview of the System's finances and to account for the money the System receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to:

Pasadena Fire & Police Retirement System
100 N. Garfield Avenue, N204
Pasadena, CA 91101

Respectfully submitted,

Jill Fosselman
Retirement Administrator

**PASADENA FIRE AND POLICE RETIREMENT SYSTEM**
**STATEMENT OF FIDUCIARY PLAN NET POSITION**
**JUNE 30, 2014, WITH COMPARATIVE TOTALS**

| | 2014 | 2013 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ 7,918,592 | $ 6,531,090 |
| Receivables: | | |
| Pending trade sales | 790,981 | 7,255,173 |
| Interest | 267,661 | 269,374 |
| Total receivables | 1,058,642 | 7,524,547 |
| Investments, at fair value: | | |
| Government and agencies | 32,697,093 | 25,808,780 |
| Domestic corporate obligations | 24,057,998 | 30,694,777 |
| International corporate obligations | 1,868,772 | 1,993,499 |
| Real estate | 16,261,014 | 14,604,925 |
| Real estate investment trust (REIT) | 256,320 | 241,809 |
| Domestic corporate stocks | 55,172,827 | 52,640,208 |
| International corporate stocks | 15,304,857 | 14,254,407 |
| Total investments | 145,618,881 | 140,238,405 |
| Total assets | 154,596,115 | 154,294,042 |
| **Liabilities** | | |
| Accounts payable and accrued liabilities | 86,304 | 69,193 |
| Pending trade purchases | 6,305,421 | 14,052,080 |
| Total liabilities | 6,391,725 | 14,121,273 |
| Net position restricted for employees' pension benefits | $ 148,204,390 | $ 140,172,769 |

The accompanying notes are an integral part of these financial statements.

## PASADENA FIRE AND POLICE RETIREMENT SYSTEM
## STATEMENT OF CHANGES IN FIDUCIARY PLAN NET POSITION
## FOR THE YEAR ENDED JUNE 30, 2014, WITH COMPARATIVE TOTALS

| | 2014 | 2013 |
|---|---|---|
| **Additions:** | | |
| Contributions: | | |
| Employer | $ 1,164,000 | $ - |
| Net investment income: | | |
| Net change in fair value of investments | 17,782,040 | 12,886,120 |
| Interest | 2,211,690 | 1,812,766 |
| Dividends | 1,128,886 | 1,305,036 |
| Other income | 520,000 | - |
| Gross investment income | 21,642,616 | 16,003,922 |
| Less investment expenses | (338,651) | (373,953) |
| Net investment income | 21,303,965 | 15,629,969 |
| Total additions | 22,467,965 | 15,629,969 |
| **Deductions:** | | |
| Benefits paid to participants | 14,140,462 | 14,322,245 |
| Administrative expenses | 295,882 | 271,035 |
| Total deductions | 14,436,344 | 14,593,280 |
| Net Increase in Fiduciary Plan Net Position | 8,031,621 | 1,036,689 |
| **Net position restricted for employees' pension benefits:** | | |
| **Beginning of year** | 140,172,769 | 139,136,080 |
| **End of year** | $ 148,204,390 | $ 140,172,769 |

The accompanying notes are an integral part of these financial statements.

## NOTE 1 – PENSION PLAN DESCRIPTION

### General

The Pasadena Fire and Police Retirement System ("System") is a defined benefit plan governed by a Board of Retirement ("Board") under provisions of the City of Pasadena ("City") Charter. The Board has sole and exclusive responsibility over the assets of the System and the responsibility to administer the System to assure prompt delivery of benefits and related services as provided in Article XV of the City Charter. The Board consists of five members, and members as of June 30, 2014, were as follows:

Keith Jones, Chair
Peter Boyle, Board Member
John Brinsley, Board Member
Joe Milligan, Board Member
Terry Tornek, Board Member

The System covers all sworn fire and police personnel who were employed by the City prior to July 1, 1977, except for those who elected to transfer to the California Public Employees' Retirement System ("CalPERS") when the System closed to new members in June 2004. In June 2004, active members were provided a one-time opportunity to transfer from the System to CalPERS as provided by an agreement with the City. Once transferred to CalPERS, retirement benefits for all fire and police personnel employed thereafter are provided under CalPERS.

The System is a single-employer public employees' retirement system which is included as a pension trust fund in the financial statements of the City of Pasadena, California. The System provides basic lifetime retirement, disability, and death benefits to members who meet the minimum age and length-of-service requirements.

As of June 30, 2014, the System membership consisted of 247 retirees and beneficiaries who receive benefits. The average age was 77.1 years and the average monthly benefit was $4,689. Since June 30, 2013, the plan experienced 10 deaths without a beneficiary, six deaths with a beneficiary and six new beneficiaries for a net reduction of 10 participants. On June 30, 2014, total membership in the plan consisted of:

- 98 Service Retirees (average age 76.3, average monthly benefit $5,747)
- 90 Disability Retirees (average age 74.3, average monthly benefit $4,496)
- 59 Beneficiaries (average age 82.8, average monthly benefit $3,224)

There are no longer any active employees participating in the System, and the System is closed to new entrants. Benefit provisions are established and, subject to any constitutional limitations, may be amended by the City Charter.

### Pension Plan Benefits

Members are entitled to annual pension benefits beginning at normal retirement age (50) equal to 1/50 of final compensation, times the member's number of years of service, times an actuarial equivalent based on the actual retirement age. The System permits service retirement at age 50, provided at least 15 years of service have been rendered, or retirement after 25 years of service, regardless of age.

### Disability Benefits

Generally, active members who become totally disabled receive annual disability benefits that are equal to 50% of final compensation.

**NOTE 1 – PENSION PLAN DESCRIPTION** (Continued)

**Death Benefits**

In the case of a death before a member is eligible to retire, there is a refund of the employee contributions, with interest, plus six months' salary. If the member is eligible to retire, 60% of the earned benefit is payable to the eligible surviving spouse for their lifetime.

**Survivor Benefits**

Upon the death of a retiree, the qualified beneficiary is entitled to receive retirement benefits equal to 60% continuance for a service retirement and 100% continuance for a service-connected disability retirement.

**Cost of Living Adjustment ("COLA")**

Monthly retiree benefits are eligible for an annual cost of living adjustment based on the increase/decrease of the annual average in the Consumer Price Index ("CPI") for the Los Angeles-Riverside-Orange County, California area for the previous year, January to December, and the change is rounded to the nearest whole percentage. The adjustments are calculated by the actuary, adopted by the Board, and become effective on July 1 of each year. The COLA for 2014 was an increase of 1.0%.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The System follows the accounting principles and reporting guidelines as set forth in Statement No. 25 of the Governmental Accounting Standards Board ("GASB"). The financial statements are prepared and presented using the accrual basis of accounting. Member and employer contributions are recognized in the period in which the contributions are due and when the City has made a formal commitment to provide the contributions. Benefits are recognized when payable, in accordance with the terms of the System.

**Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Reporting Entity**

The System's annual audited financial statements are included in the City of Pasadena's financial reports as a pension trust fund.

**Cash and Cash Equivalents**

The System's cash and short-term investments are managed by Northern Trust (master custodian for investment securities) and the City Treasurer.

**City Treasury**

Cash necessary for the System's daily operations is pooled with other City funds for short-term investment by the City Treasurer. The City is responsible for the control and safekeeping of all instruments of title and for all investment of the pooled funds.

The System has designated $1,250,000 in cash reserves to be invested by the City Treasurer in pooled cash. The funds equal one month of benefits and administrative expenses and are restricted for use in the event of a major emergency or disaster.

**NOTE 2 – <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u>** (Continued)

**<u>Method Used to Value Investments</u>**

Investments are reported at fair value. Fair value for investments of publicly traded stocks and bonds and issues of the U.S. Government and its agencies is based on the last reported sale price as of the fiscal year-end. Fair value of securities denominated in a foreign currency reflects exchange rates in effect at fiscal year-end. Fair value of investments in commingled funds in real estate is based on the fund share price provided by the fund manager which is based on net asset value. Fair value of investments in commingled funds in bank loans is the fund share price provided by the fund manager which is based on the market value of the fund.

Investment transactions are accounted for on the date the securities are purchased or sold (trade date). Unsettled investment trades as of fiscal year-end are reported in the financial statements on an accrual basis. The corresponding proceeds due from sales are reported on the Statement of Fiduciary Plan Net Position under Receivables and labeled as Pending trade sales, and amounts payable for purchases are reported under (Current) Liabilities and labeled as Pending trade purchases. Dividend income is recorded on ex-dividend date, and interest income is accrued as earned. The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of System's investment. Realized gains and losses on investments that had been held in more than one reporting period and sold in the current period were included as a change in the fair value reported in the prior period(s) and the current period.

**<u>Implementation of Accounting Standards</u>**

GASB, which sets accounting principles generally accepted in the United States of America ("GAAP") for governments, including the System, recently issued several statements.

For the year ended June 30, 2014, the System was required to implement and implemented the following standards:

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that classify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. There was no effect on the System's accounting or financial reporting as a result of implementing this standard. GASB Statement No. 66, *Technical Corrections - an amendment of GASB Statements No. 10 and No. 62*, which improves accounting and financial reporting for a government financial reporting entity by resolving conflicting guidance that resulted from the issuance of GASB Statements No. 10 and 62, had no effect on the System's accounting and financial reporting as a result of implementing this standard. GASB Statement No. 67, *Financial reporting for Pension Plans - an amendment of GASB Statement No. 25*, represents one of the most significant fundamental changes in reporting requirements for pension plans and plan sponsors in over a decade. This statement was approved in June 2012 and enhances accountability and transparency through revised and new note disclosures and required supplementary information. The standard builds upon the existing framework for financial reports, enhances the note disclosures and required supplementary information. Significant changes include an actuarial calculation of total and net pension liability to the discount rate, and increase investment activity disclosures including annual money-weighted rates of return. The total pension liability, determined in accordance with this statement, is presented in Note 5, Net Pension Liability, and in the Required Supplementary Information (RSI). The System's funding status is no longer included in RSI. The System also implemented GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, however, there was no effect on the System's accounting and financial reporting as a result of implementing this standard.

## NOTE 2 – <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u> (Continued)

### <u>Income Taxes</u>

The Internal Revenue Service has ruled that plans such as the System qualify under Section 414(d) of the Internal Revenue Code and are not subject to tax under present income tax laws. On May 11, 2012, the Internal Revenue Service issued a favorable Tax Determination Letter. Working in conjunction with the City Attorney to fulfil the conditions of the favourable determination letter, the System revised the Pasadena Municipal Code and the changes became effective December 6, 2012. Accordingly, no provision for income taxes has been made in the accompanying basic financial statements, as the System is exempt from federal and state income taxes under provisions of the Internal Revenue Code, Section 414, and the California Revenue and Taxation Code, Section 23701, respectively.

### <u>Reclassifications</u>

Comparative data for the prior year has been presented in the selected sections of the accompanying *Statement of Fiduciary Net Position* and *Statement of Changes in Fiduciary Net Position*. Also, certain accounts presented in the prior year's data may have been reclassified to be consistent with the current year's presentation.

## NOTE 3 – <u>INVESTMENTS</u>

### <u>Authorized Investments</u>

The City Charter, Article XV Section 1502, confers the authority and fiduciary responsibility for investing the System's funds on the Board. As set forth below, Board members are subject to carry out their duties in the manner of a prudent person familiar with such retirement and investment matters acting under similar circumstances. Investments shall be subject to the same terms, limitations, and restrictions as are imposed by the Constitution and laws of the State upon the investment of the CalPERS funds, as now enacted or hereafter amended. This prudent expert rule permits the Board to make investment allocation decisions and diversify investment holdings to reduce overall risk and increase returns. The prudent expert rule also permits the Board to establish an investment policy based on professional advice and counsel, and allows for the delegation of investment authority to professional investment managers. The System's investment policy outlines the responsibility for the investment of the funds and the degree of risk deemed appropriate for the System's investments. Investment managers are contractually bound to carry out their responsibilities in accordance with the Board's investment policy and to follow specific contractual guidelines.

The Board oversees and guides the System subject to the following basic fiduciary responsibilities:

- Solely in the interest of, and for the exclusive purpose of, providing economic benefits to participants and their beneficiaries.
- With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character with like objectives.
- Diversify the investments of the System so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances, it is clearly prudent not to do so. Diversification is applicable to the deployment of the assets as a whole.

Pursuant to this authority, the Board has authorized investment in the following securities:

- Securities of the U.S. Government or its agencies
- Certificates of Deposit, or Time Deposits, placed with commercial banks and savings and loan associations
- Negotiable Certificates of Deposit
- Bankers' Acceptances
- Commercial Paper (rated A-1/P-1 or better)

**NOTE 3 – INVESTMENTS** (Continued)

**Authorized Investments** (Continued)

- Medium-Term Corporate Notes
- Corporate and Municipal Bonds
- Preferred Stock
- Common Stock
- Fixed-Income Funds
- Senior Bank Loans
- Foreign Stock and Corporate Bonds
- Mutual Funds
- Liquid Alternative Investments
- Real Estate Investment Trust ("REIT")
- Private Real Estate
- Treasury Inflation Protected Securities

The Board established an Investment Performance Statement (IPS) effective May 21, 2009, with revisions on September 17, 2009, May 20, 2010, June 16, 2011, June 20, 2013, and May 15, 2014 in accordance with applicable local, State, and Federal laws. The Board exercises authority and control over the management of the System's assets by setting policy which the Board executes through the use of external prudent experts.

The IPS encompasses the following asset classes and the asset allocation targets:

Domestic Core Fixed Income – 30%
Large Cap Domestic Equity – 18% (9.0% Large Cap Value, 9.0% Large Cap Growth - Passive)
Small-Mid Cap Core Equity – 4%
International Equity – 20%
Private Real Estate – 10%
Senior Bank Loans – 5%
Liquid Alternative Investment – 5%
Treasury Inflation Protected Securities (TIPS) – 5%
Cash – Short-Term Investment Fund (STIF) – 3%

The System requires approximately $1,250,000 per month to cover benefit payments and administrative costs. On a quarterly basis, the Board and the investment consultant evaluate the assets against their allocation targets and determine the appropriate asset class/classes from which to withdraw for payment of benefits and administration. This process also serves as regular rebalance process to ensure that the portfolio stays within the Board's adopted allocation goals.

Asset Allocation Policy and Expected Long-term Rate of Return by Asset Class

The investments of the System are allocated by the IPS as approved by the Board and noted in the following table. In comparison to June 30, 2013, the 2014 allocation reflects a new allocation of 5% to senior Bank Loans, which was achieved through reducing the allocation to Domestic Equities by 5%. The long-term geometric expected real rates of return are provided by asset class, and are based on CalPERS' capital markets assumptions studies.

**NOTE 3 – INVESTMENTS** (Continued)

**Authorized Investments** (Continued)

Asset Allocation Policy and Expected Long-term Rate of Return by Asset Class (Continued)

| | 6/30/2014 | | 6/30/2013 | |
|---|---|---|---|---|
| **Asset Class** | **Target Asset Allocation** | **Expected Geometric Real Return**** | **Target Asset Allocation** | **Expected Geometric Real Return*** |
| Domestic Equities | 22% | 5.00% | 27% | 5.35% |
| Foreign Equities | 20% | 5.00% | 20% | 5.35% |
| Fixed Income | 30% | 0.74% | 30% | 1.55% |
| TIPS | 5% | 0.20% | 5% | 1.53% |
| Bank Loans | 5% | 0.74% | n/a | n/a |
| Hedge Funds | 5% | 3.14% | 5% | 5.35% |
| Real Estate | 10% | 4.25% | 10% | 3.83% |
| Cash | 3% | 0.00% | 3% | 0.45% |
| Inflation | | 3.00% | | 3.00% |

*Source is the June 30, 2014 actuarial valuation prepared by System Actuary, Bartel Associates.*
**Long-term geometric expected real rates of return based on adjusted capital market assumptions from CalPERS' 2010 capital market assumptions study.*
***Geometric expected real rates of return from CalPERS' 2013 capital market assumptions study.*

Rate of Return

For the year ended June 30, 2014, the annual money-weighted rate of return on the System's investments, net of investment expenses, was 15.4%. The money-weighted rate of return expresses investment performance, net of investment fees, adjusted for the changing amounts actually invested.

**Deposit and Investment Risks**

The System adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment to GASB Statement No. 3*, effective July 1, 2004. GASB Statement No. 40 is designed to inform financial statement users about deposit and investment risks that could affect the ability to provide services and meet obligations as they become due. The disclosures required by this statement provide information to assess common risks inherent in deposit and investment transactions. Deposit and investment resources represent considerable assets of the System, and these resources are necessary to carry out fiduciary responsibilities. GASB Statement No. 40 requires the disclosure of the following specific risks that apply to the System's investments:

- Credit Risk and Fair Value of Investments
- Custodial Credit Risk – Deposits and Investments
- Concentration of Credit Risk
- Interest Rate Risk
- Highly Sensitive Investments
- Foreign Currency Risk
- Cash and Investments

**NOTE 3 – <u>INVESTMENTS</u>** (Continued)

**<u>Deposit and Investment Risks</u>** (Continued)

GASB Statement No. 40 also requires the disclosure of deposit or investment policies (or the lack thereof) that relate to the investment and custodial risks that are required to be disclosed.

The Board has chosen to manage the investment risks described by GASB Statement No. 40 by contractually requiring each portfolio investment manager to abide by the IPS, specifically tailored to that individual manager, rather than adopting across-the-board investment policies with respect to these investment risks. At the end of June 30, 2014, the System had nine external investment managers and 11 assets. The fixed income policy stipulates the strategy and investments, investment process, quality constraints, duration constraints, diversification, cash reserves, derivatives, and rate of return expectation.

**<u>Credit Risk</u>**

Credit risk is the risk that the issuer of a debt security or other counterparty to an investment will not fulfill its obligations. The individual investment guidelines for the fixed income investment manager describe applicable restrictions on credit risk. The System seeks to maintain a diversified portfolio of fixed income instruments in order to obtain the highest total return for the fund at an acceptable level of risk within this asset class.

The credit quality ratings of investments in fixed income securities by a nationally recognized statistical rating organization, Standard and Poor's ("S & P"), as of June 30, 2014, are as follows:

**Credit Quality Ratings of Investments in Fixed Income Securities**

| Quality Ratings - S & P | Market Value | Percentage | Notes |
|---|---|---|---|
| AAA | $ 2,357,484 | 4.02% | AAA |
| AA | 5,547,609 | 9.46% | AA, AA-, AA+ |
| A | 3,930,228 | 6.70% | A-, A, A+ |
| BBB | 4,566,070 | 7.79% | BBB, BBB-, BBB+ |
| BB | 74,173 | 0.13% | BB |
| B | 555,497 | 0.95% | B, B+ |
| CCC | 636,156 | 1.09% | CCC |
| CC | 8,483 | 0.01% | CC |
| Subtotal Securities with S&P Ratings | 17,675,700 | 30.15% | |
| U.S. Government Guaranteed Securities* | 25,874,168 | 44.14% | AGY, TSY |
| Not Rated/Quality Rating N/A** | 15,073,995 | 25.71% | Includes PIMCO asset |
| Total | $ 58,623,863 | 100.00% | |

** Consists of U.S. Government Bonds and Government Mortgage-Backed Securities, minus ST bills and notes of $1,759,927. The rating agencies normally do not rate government agency and treasury debt and therefore they have an implied AAA rating.*
*** Minus not rated "cash holdings": STIF of $3,735,812, commercial paper of $869,845, and cash (bank notes) of $99,984.*

**NOTE 3 – INVESTMENTS** (Continued)

**Custodial Credit Risk – Deposits**

Custodial credit risk for deposits is the risk that, in the event of a financial institution's failure, the System will not be able to recover the value of deposits nor be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not insured or not collateralized. As of June 30, 2014, the System was not exposed to such risk on the fair value of total international investments. The System does not have a formal policy for custodial credit risk.

**Custodial Credit Risk – Investments**

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The individual investment guidelines for each investment manager require that managed investments be held and maintained with the master custodian in the name of the System. Investment securities are exposed to custodial credit risk if the securities are uninsured, or are not registered in the System's name, and held by the counterparty. The System's investments are not exposed to custodial credit risk if they are insured or registered in the System's name. The System's investments are not exposed to custodial credit risk because all securities are held by the System's custodial bank in the System's name.

**Concentration of Credit Risk**

Concentration of credit risk is the risk of potential loss attributed to the magnitude of the System's investment in a single issuer of securities. The Board's investment policies and guidelines permit investments in numerous specified asset classes to take advantage of professional investment management advice and a well-diversified portfolio. The fixed income manager develops and applies diversification standards as deemed prudent, and is expected to maintain diversification by sector and issue. Allocations to any one issuer in the fixed income account (excepting issues issued by or explicitly guaranteed by the U.S. government) should not exceed 5% of the total account fair market value.

The Fiduciary Net Position (FNP) on June 30, 2014 was $148,204,390. The System's fixed income investment holdings that represented 5.0% or more of FNP as of June 30, 2014, are as follows:

**Fixed Income Securities**
**As of June 30, 2014**

**Concentration of Credit Risk by Issuer**

| Issuer | Fair Value | % of Total Fair Value |
|---|---|---|
| Federal National Mortgage Association | $ 7,870,435 | 5.3% |

** Investors have an implicit guarantee from the federal government.*

**Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Duration is a measure of the price sensitivity of a fixed income portfolio to changes in interest rates. It uses the present values of cash flows, weighted for those cash flows as a percentage of the investment's full price. The longer the duration of a portfolio, the greater its price sensitivity is to changes in interest rates.

While no specific ranges are required, one of the ways the System manages its exposure to interest rate risk is by requiring the fixed income investment manager to maintain their portfolio effective duration within +/- 20% of the benchmark, the Barclays Capital U.S. Aggregate Bond Index. The effective duration is a measure, in years, of interest-rate sensitivity in debt investments. The longer the effective duration, the greater the sensitivity to interest rate changes.

**NOTE 3 – INVESTMENTS** (Continued)

**Interest Rate Risk** (Continued)

Information about the sensitivity of the fair values of the System's investments to market interest rate fluctuations is provided by the following table that shows the weighted average effective duration of the System's fixed income investments by investment type as of June 30:

**MetWest Fixed Income Asset Manager**
**Effective Duration**

| June 30, 2014 | | | | |
|---|---|---|---|---|
| Market Value | | Duration | Benchmark | % Under/Over |
| $ | 45,858,083 | 4.63 Years | 5.60 Years | -17% |

| June 30, 2013 | | | | |
|---|---|---|---|---|
| Market Value | | Duration | Benchmark | % Under/Over |
| $ | 43,690,404 | 4.57 Years | 5.49 Years | -17% |

Note:
*Source is the 6-30-14 and 6-30-13 MetWest asset manager Investment Performance Reviews.*

**Highly Sensitive Investments**

Highly sensitive investments are certain debt investments whose terms may cause their fair value to be highly sensitive to market interest rate changes. Terms include such information as embedded options, coupon multipliers, benchmark indexes, and reset dates. The System's asset-backed investments have embedded prepayment options that will typically cause prepayments by the obligees of the underlying investments when interest rates fall. Prepayments eliminate the stream of future interest payments and, therefore, diminish the fair value of the asset-backed investment. The following table shows the fair value of the System's asset-backed investments by investment type:

| Investment Type | | 2014 |
|---|---|---|
| Government Mortgage-Backed Securities | $ | 11,938,379 |
| Government Issued Commercial-Mortgage-Backed Securities | | 1,033,690 |
| Asset-Backed Securities | | 5,782,744 |
| Commercial Mortgage-Backed Securities | | 1,944,435 |
| Non-Government-Backed Commercial Mortgage Obligations | | 2,530,355 |
| Total | $ | 23,229,603 |

**NOTE 3 – INVESTMENTS** (Continued)

**Foreign Currency Risk**

Foreign currency risk is the risk that changes in foreign exchange rates will adversely affect the fair value of an investment or deposit. The System's authorized investment managers are permitted to invest in approved countries or regions, as stated in their respective investment guidelines. Currency hedging will be permitted as part of a defensive strategy to protect the portfolio's underlying assets.

The System's foreign investment holdings as of June 30, 2014, are as follows:

| Foreign Currency Type - Corporate Bonds | Fair Value in USD | % of Total Fair Value |
|---|---|---|
| Australia | $ 254,321 | 0.17% |
| Cayman Islands | 249,830 | 0.17% |
| Cayman Islands (Asset Backed Securities) | 489,364 | 0.35% |
| Netherlands | 104,475 | 0.07% |
| United Kingdom | 510,440 | 0.35% |
| Switzerland | 260,342 | 0.18% |
| Total Foreign Currency | $ 1,868,772 | 1.29% |
| **Foreign Currency Type - Equities** | | |
| International Region | $ 15,304,857 | 10.44% |
| Total Foreign Currency | $ 15,304,857 | 10.44% |
| **ALL FOREIGN CURRENCY** | $ 17,173,629 | 11.71% |

At the February 16, 2012 Board meeting, the Board directed Wurts Associates to sell 50% of the Dodge & Cox International Stock Fund and purchase American Funds EuroPacific Growth Fund with the proceeds to further diversify the international asset space. Although the EuroPacific mutual fund asset is in U.S. dollars, all holdings are outside the U.S., and normally, at least 80% of assets must be invested in securities of issuers in Europe or the Pacific Basin. Since the asset is held in dollars, it is not recognized in the above chart, under Foreign Currency Type - Equities, which highlights foreign currency holdings.

As of June 30, 2014, the total amount in the portfolio held in the International Equity space totaled $30,459,790 (Dodge & Cox International Fund $15,304,857 and EuroPacific Growth Fund $15,154,932). This total amount reflects 20.78% of the portfolio, and is consistent with the allocation target of 20% in International Equity.

**Cash and Investments**

Cash and investments as of June 30 were held as follows:

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| | (In Thousands) | |
| Unrestricted Pooled Cash | $ 203 | $ 542 |
| Restricted Pooled Cash | 1,250 | 1,250 |
| Cash with Fiscal Agent* | 6,466 | 4,739 |
| Investments - Held by Trustee | 145,619 | 140,238 |
| | $ 153,538 | $ 146,769 |

Note:
** Cash with Fiscal Agent includes pending trade sales and purchases.*

## NOTE 4 – <u>CONTRIBUTION INFORMATION</u>

Contribution requirements are established by the City Charter and by contract, and, subject to any constitutional limitations, may be amended by the City Charter or further agreement between the City and the System.

### General

Historically, the City has made monthly contributions to the System based on actuarially determined employer contribution rates which, together with employee contributions, were expected to provide sufficient assets to pay funded basic benefits when due. However, the City Charter did not require actuarially determined funding for unfunded basic, 1919 benefits, and COLA benefits, which are funded under Contribution Agreement No. 16,900, dated March 18, 1999, between the City and the System. Per the terms negotiated through their respective recognized Associations, employee contributions of 9% for both fire and police personnel base earnings were made by the City on behalf of the employees and credited to their individual accounts.

### Member Contributions

As a condition of participation, members were required to contribute a percentage of their annual salary to the System. Currently there are no active members in the System, and hence no further member contributions are due to the System.

The City Charter requires members' contributions to be credited to the individual account of the member from whose compensation the contribution was deducted. Such contributions accrue interest at a rate determined by the Board and are either to be refunded to members or their beneficiaries upon separation from City service for reasons other than retirement, or to be applied towards providing members' retirement or death allowances. Amendments to the City Charter cannot prevent the refund of such contributions plus accrued interest. Because there were no active members, accumulated contributions at June 30, 2014, were $0 with no interest credited for 2014.

### City Contributions

The System's funding mechanism was updated on March 18, 1999, when the System entered into Contribution Agreement No. 16,900 (Agreement No. 16,900) with the City. As a result of this agreement, the City made a contribution of $100,000,000 to the System on August 5, 1999 and agreed to make supplemental contributions to the System when needed. Per Agreement No. 16,900, the System was considered to meet minimum funding requirements for the year ended June 30, 2001, if the funded percentage exceeded 70%. As per the agreement, the required minimum funded percentage increases by 1/2% each year until it reaches 80% in the year ending June 30, 2020. Thereafter it may, but need not, be changed by the System.

On October 20, 2011, the Board approved Amended and Restated Agreement No. 20,823 (Agreement No. 20,823). Under this new agreement, the City's minimum funding percentage schedule and reimbursement cap in Agreement No. 16,900 carried forward, and the City agreed to provide a contribution of $46,600,000 to the System through the issuance of pension obligation bonds. Agreement No. 20,823 provided that the annual required supplemental contribution would be actuarially calculated using an interest assumption of 6% and an inflation rate of 3% beginning with the June 30, 2012 valuation. Pursuant to this agreement, future annual valuations after June 30, 2012, shall adopt an assumed interest rate and inflation assumption based on analysis performed by the System's actuary and after seeking input from the City and System's professional consultant. Agreements No. 16,900 and No. 20,823 state that if the minimum funding deficit is greater than $3,000,000 in a year, the City will pay $3,000,000 to the System. Any remaining amount necessary to reach the minimum funding percentage will be phased in over a five-year period; however, no annual supplemental payment may exceed a reimbursement cap measured by the prior year's payments for benefits other than the funded basic benefits.

**NOTE 4 – CONTRIBUTION INFORMATION** (Continued)

**City Contributions** (Continued)

To allow the City time to issue such pension obligation bonds and complete the validation proceeding as required in Agreement No. 20,823, the January 3, 2012 due date for the supplemental contribution was extended until March 31, 2012. Pursuant to Agreement No. 20,823, as long as the net proceeds were provided to the System by that date, they would be treated as assets of the System as of June 30, 2012, and therefore as of that date there would be no funding deficit in the minimum funding requirement, and consequently, no Supplemental Contribution owed to the System by the City for the fiscal year ending June 30, 2012. Net bond proceeds in the amount of $46,600,000 were received by the System on March 29, 2012.

As of June 30, 2014, the funded percentage of the System, calculated in accordance with Agreement No. 20,823 and Agreement No. 16,900, was 81.6%. As provided by Contribution Agreement No. 16,900, if the funded percentage is below the minimum funding percentage of 77.0% for fiscal year 2014, the City will reimburse the System in the following fiscal year subject to certain reimbursement limits. Based on the June 30, 2014 actuarial valuation, the funding deficiency was $0, or 0%, below the funding requirement of 77.0% as of June 30, 2014. Thus, no required supplemental contribution is owed to the System by the City for the fiscal year ended June 30, 2014, on January 1, 2014.

**NOTE 5 – NET PENSION LIABILITY**

**Net Pension Liability**

Net Pension Liability (NPL) for the plan on June 30, 2014 was $11,312,000 which reflects a net funded status of 92.9%. The components of the net pension liability of the System at June 30, 2014 and 2013, are as follows:

**Net Pension Liability**
(Amounts in 000's)

| **Net Pension Liability** | **6/30/2014** | **6/30/2013** |
|---|---|---|
| Discount Rate | 6.00% | 6.00% |
| Total Pension Liability | $ 159,516 | $ 168,781 |
| Fiduciary Net Position (FNP) | 148,204 | 140,173 |
| Net Pension Liability (NPL) | $ 11,312 | $ 28,608 |
| Funded Status (FNP/TPL) | 92.9% | 83.1% |

**Actuarial Assumptions**

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and cost trends. Actuarially determined amounts are subject to continual review or modification as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employers and plan members) and include the types of benefits provided at the time of each valuation. The total pension liability was determined by the actuarial valuation performed as of June 30, 2014, using the following actuarial assumptions:

**NOTE 5 – <u>NET PENSION LIABILITY</u>** (Continued)

**<u>Actuarial Assumptions</u>** (Continued)

Upon analysis provided by the System's Actuary on June 19, 2014, the Board accepted the recommended assumptions (that were concurred with by City Treasury and the System's Investment Advisor) for use in the preparation of the actuarial valuation for the fiscal year ending June 30, 2014.

| | | |
|---|---|---|
| Valuation Date/Measurement Date | June 30, 2014 | |
| Actuarial Cost Method | Entry Age Normal Cost Method | |
| Geometric Real Rates of Return | Based on CalPERS 2013 10-year Expected Geometric Returns | |
| | Global Equity | 5.00% |
| | Fixed Income | .74% |
| | TIPS | 20% |
| | Hedge Funds | 3.14% |
| | Real Estate | 4.25% |
| | Cash Equivalents | 0.00% |
| Actuarial Assumptions | Discount Rate | 6.0% |
| | Salary Scale | No active employees |
| | Cost of Living | 3.0% |
| Mortality | CalPERS 1997-2007 Experience Study, Projection Scale AA | |

**<u>Key Methods and Assumptions Used in Valuation of Total Pension Liability</u>**

The following chart notes the changes in the number of participants (from 257 to 247 total participants on June 30, 2014), and the major actuarial assumptions applied in the System's calculation of Total Plan Liability.

**NOTE 5 – NET PENSION LIABILITY** (Continued)

**Key Methods and Assumptions Used in Valuation of Total Pension Liability** (Continued)

**System Members and Actuarial Assumptions**

| | **6/30/2014** | **6/30/2013** |
|---|---|---|
| **Number of Participants** | | |
| Retirees & Beneficiaries | 247 | 257 |
| Vested Terminations | 0 | 0 |
| Actives | 0 | 0 |
| TOTAL | 247 | 257 |
| **Major Assumptions** | | |
| Discount Rate* | 6.00% | 6.00% |
| Municipal Bond Rate** | n/a | n/a |
| Pay Increases | n/a | n/a |
| Ad Hoc COLAs | n/a | n/a |
| Inflation | 3.00% | 3.00% |
| Mortality | CalPERS 1997-2007 | CalPERS 1997-2007 |
| Mortality Improvement | Projection Scale AA | Projection Scale AA |

*Notes:*
*Source is the June 30, 2014 actuarial valuation prepared by System Actuary, Bartel Associates.*
** Discount Rate reflected assumed investment expenses of 40bp.*
*** Not applicable since the trust is projected to have assets to pay all benefits per the current funding policy.*

**Discount Rate**

The discount rate of 6% used for the June 30, 2014 Total Pension Liability was selected by the System actuary as follows:

- City contributions, benefit payments, and administrative expenses were projected for the lifetime of the System.
- The investment policy target cash allocation was adjusted for each year of the projection period to include additional cash to the extent projected benefit payments plus administrative expenses less City contributions exceeded the target cash allocation.
- The expected return on non-cash assets was determined using the non-cash target asset allocation, expected short-term (10-year) and long term (> 10-year) returns, and assumed investment expenses of 0.40%. Expected returns were based on capital market assumptions provided to CalPERS by their investment advisors in 2013.
- A discount rate was determined for each future year as the weighted average of the non-cash and cash expected returns.
- A single equivalent discount rate was determined that provided the same Total Pension Liability as the projected annual discount rates.

**NOTE 5 – NET PENSION LIABILITY** (Continued)

**Sensitivity of the Net Pension Liability (NPL) to Changes in the Discount Rate**

Examining the sensitivity of the NPL to changes in the discount rate by a 1% decrease, from 6% to 5%, revealed an increase in the NPL by $15,013,000 to a total NPL of $26,325,000 as of June 30, 2014. Similarly, increasing the discount rate by 1%, from 6% to 7%, revealed a corresponding decrease in the NPL of $12,852,000 to a net surplus in the NPL of ($1,540,000) as of June 30, 2014.

**Sensitivity of Net Position Liability (NPL) to Changes in the Discount Rate**

| | 6/30/2014 | 6/30/2013 |
|---|---|---|
| Discount Rate | 6.00% | 6.00% |
| Net Pension Liability (NPL) | $ 11,312 | $ 28,608 |
| | | |
| Discount Rate (-1%) | 5.00% | 5.00% |
| Net Pension Liability (NPL) | 26,325 | 44,827 |
| *Net Increase/(Decrease) in NPL* | *15,013* | *16,219* |
| | | |
| Discount Rate (+1%) | 7.00% | 7.00% |
| Net Pension Liability (NPL) (Surplus) | (1,540) | 14,763 |
| *Net Increase/(Decrease) in NPL* | *(12,852)* | *(13,845)* |

**NOTE 6 – ADMINISTRATIVE COSTS**

The costs to administer the System are paid by the System. Administrative expenses were $295,882 for 2014 and $271,035 for 2013. Administrative expenses increased by a net amount of $24,847 in 2014 and were primarily attributed to the cost for an audit of the Concord Senior Housing facility that was transferred from the City. However, $520,000 in ground lease rent income was also transferred to the System as a result of the audit, and this funding was used to reduce the amount needed to be withdrawn from the portfolio for 1st Quarter 2014 pension benefits.

**NOTE 7 – SETTLEMENT AGREEMENT**

In October 2002, the Retirement Board accepted the Actuarial Valuation Report, dated June 30, 2002, including the adoption of a 20% corridor concept in the asset smoothing method. The corridor concept set a 20% corridor around the fair value of the assets, which the actuarial value of assets was required to stay within, to ensure that the actuarial value of the assets did not vary significantly from the fair value. This method resulted in a minimum funding deficit of $11,828,000 and a City contribution under the Contribution Agreement of $4,766,000 that would be due in the subsequent fiscal year. However, the City disputed the use of the corridor concept and in January 2003 engaged an actuary to provide an opinion as to the appropriateness of the corridor concept. Excluding the use of the corridor concept, the City calculated the minimum funding deficit to be $80,000. The City contributed this amount to the System in January 2003.

During 2003, the System filed a claim against the City for payment of the larger amount of the above contribution. This claim was deemed denied by the non-response of the City. In November 2003, the Board accepted the Actuarial Valuation Report, dated June 30, 2003, which utilized the 20% corridor concept in the asset smoothing method. This method resulted in a minimum funding deficit of $20,296,000 and a City contribution under the Contribution Agreement of $8,143,000 that would be due in January 2004.

**NOTE 7 – SETTLEMENT AGREEMENT** (Continued)

In June 2004, the City and the System entered into Settlement and Release Agreement No. 18,550 ("Settlement Agreement") to settle the disputed use of the corridor method and the payment of the supplemental contributions. Under the terms of the Settlement Agreement, the City made contributions of $15,000,000, $15,000,000, and $10,000,000 in August 2004, October 2004, and December 2004, respectively. In addition, a debenture was issued by the City in June 2004 for $13,736,000 and the debenture was to be funded by the contributions provided for by the Settlement Agreement. Contribution amounts in excess of the debenture were applied to the supplemental contribution that was due to the System in January 2005. In consideration, the System agreed to eliminate the use of the corridor concept methodology in all actuarial valuations on or subsequent to June 30, 2005, subject to certain exceptions if actuarial standards or practices were changed, or the City failed to make any required contribution. As of June 30, 2005, $40,000,000 was collected by the System.

In October 2005, the Retirement Board accepted the Actuarial Valuation Report dated June 30, 2005. The valuation included the $40,000,000 of contributions received by the System under the Settlement Agreement, and allocated the $13,736,000 used to repay the debenture issued in June 2004 as a contribution and asset as of June 30, 2004, based upon the provisions of the Settlement Agreement. The debenture of $13,736,000 replaced earlier debentures issued by the City for Supplemental Contributions under Agreement No. 16,900. The payments under the Settlement Agreement in excess of the amount allocated to the debenture and included in the System assets in the prior year were included in System assets as of June 30, 2005.

**NOTE 8 – TRANSFER OF MEMBERS TO CALPERS**

In June 2004, active members were provided a one-time opportunity to transfer from the System to CalPERS, as provided by an agreement between the City and CalPERS. Ten members elected to transfer to CalPERS, and in July 2004 assets of $4,687,000 attributable to these members was transferred to CalPERS. These were recognized as payables in fiscal year 2004.

**NOTE 9 – CONCORD SENIOR HOUSING**

The City Board of Directors adopted Resolution No. 6179 at its July 18, 1989 meeting assigning a 93% beneficial interest in the Concord property at 275 E. Cordova, Pasadena, to the System, and 100% of the cash flow received by the City from the property for ground lease rent payments through 2031. The property is currently used for federally subsidized housing and is subject to federal restrictions on its use through August 2016. Resolution No. 6179 also declared the City's formal intent to continue to utilize the property for federally subsidized housing through 2031.

Given the significant uncertainties surrounding the property, including the value of the assignment of "beneficial interest," the ability of the City to collect ground lease rent from residual receipts, and permitted future use of the property by the City, the System's interest in this asset has historically been carried at a zero value.

In June 2012, the City informed the System of the Concord property operator's desire to renegotiate the lease and extend the federal covenants for federally subsidized housing for an additional 50 years beyond the current term expiration in 2016. In addition, it was disclosed that a ground lease rent payment had been provided to the City, but that the City was under the impression that it was not allowable by the U.S. Department of Housing and Urban Development (HUD) and would need to be returned to the operator of the property.

In August 2012, the System was notified by the City that three payments of ground lease rent had been received by the City in the total amount of $520,000 for fiscal years 2009-2012 from Retirement Housing Foundation (RHF), which is the operator of the Concord property. The System worked with HUD and the City's Housing Department to obtain HUD's approval of the historical rent payments made by RHF. In January 2014, HUD provided its approval of these rents and the $520,000 received by the City was transferred to the System. The proceeds were recorded in other income in the Statement of Changes in Fiduciary Plan Net Position.

**NOTE 9 – <u>CONCORD SENIOR HOUSING</u>** (Continued)

Going forward, based on the regulatory agreement between HUD and RHF, as well as the ground lease agreement between the City and RHF, the System is entitled to receive up to $130,000 annually from the operator of the Concord property for ground lease rent, payable only through residual receipts, through 2031. In addition, unpaid rent is to accrue as a liability, and interest on the unpaid rent is to accrue as a liability at 8.5% as defined in the lease agreement between the City and RHF.

Discussions are currently ongoing regarding the potential lease extension with the current operator and its impact on the System's beneficial interest in the property and financial interest in ground lease rent. Given the significant liabilities owed to the City (and System) regarding the Concord property, the City hired an independent consultant to review a proposal from RHF to purchase/lease the property, including a revenue and income evaluation of the project. Results of the evaluation are anticipated in Fall 2014, and will provide more insight regarding potential for future income from this asset.

As of the July 31, 2013 audited financial statements for the Concord property, a total of $2,163,336 was booked as a liability for past due rent, and $2,389,106 was booked as a liability for interest on the past due rent. Of which, $4,552,442 would be allocated to the System. However, as noted above, given the uncertainties surrounding this property, no amounts have been accrued.

**NOTE 10 – <u>SUBSEQUENT EVENTS</u>**

Subsequent events have been evaluated through October 6, 2014, which is the date the financial statements were issued.

The System received updated audited financial statements for the Concord property on October 3, 2014. As of the July 31, 2014 audited financial statements for the Concord property, booked liability for past due rent increased to $2,293,336. The booked liability for interest on the past due rent increased to $2,581,278, for a total liability of $4,874,614. No payment of rent to the City for 2014 from residual receipts was identified.

# REQUIRED SUPPLEMENTARY INFORMATION

**PASADENA FIRE AND POLICE RETIREMENT SYSTEM**
**SCHEDULE OF CHANGES IN EMPLOYER'S NET PENSION LIABILITY**
**(AMOUNTS IN THOUSANDS)**
**JUNE 30, 2014**

**Changes in Total Pension Liability**
(Amounts in 000's)

| | **2013/2014*** |
|---|---|
| Total Pension Liability: | |
| Service Cost | $ - |
| Interest | 10,185 |
| Benefit Payments | (14,140) |
| Administrative Expenses | (296) |
| Experience Losses (Gains) | (5,014) |
| Assumption Changes | - |
| Benefit Changes | - |
| Net Change | (9,265) |
| Total Pension Liability at Beginning of Year | 168,781 |
| Total Pension Liability at End of Year (a) | $ 159,516 |

**Changes in Fiduciary Net Position**
(Amounts in 000's)

| | **2013/2014** |
|---|---|
| Fiduciary Net Position: | |
| Employer Contributions | $ 1,164 |
| Member Contributions | - |
| Net Investment Income | 21,303 |
| Benefit Payments | (14,140) |
| Administrative Expenses | (296) |
| Net Change (Gain) | (8,031) |
| Fiduciary Net Position at Beginning of Year | 140,173 |
| Fiduciary Net Position at End of Year* (b) | $ 148,204 |
| Net Pension Liability/(Asset) (a)-(b) | $ 11,312 |

*Source: June 30, 2014 actuarial valuation prepared by System Actuary, Bartel Associates.*

** GASB 67 requires this information be reported for 10 years. Additional years will be displayed as the information is available.*

**PASADENA FIRE AND POLICE RETIREMENT SYSTEM**
**SCHEDULE OF EMPLOYER'S NET PENSION LIABILITY**
**(AMOUNTS IN THOUSANDS)**
**JUNE 30, 2014**

**Net Pension Liability**
(Amounts in 000's)

| Date* | Discount Rate | Total Pension Liability (TPL) | Fiduciary Net Position (FNP) | Net Pension Liability (NPL)* | Funded Status (FNP/TPL) | Covered Payroll | NPL %Pay |
|---|---|---|---|---|---|---|---|
| 6/30/2014 | 6.00% | $ 159,516 | $ 148,204 | $ 11,312 | 92.9% | n/a | n/a |
| 6/30/2013 | 6.00% | 168,781 | 140,173 | 28,608 | 83.1% | n/a | n/a |

*Source: June 30, 2014 actuarial valuation prepared by System Actuary, Bartel Associates.*

** GASB 67 requires this information be reported for 10 years. Additional years will be displayed as the information is available.*

## PASADENA FIRE AND POLICE RETIREMENT SYSTEM
## SCHEDULE OF EMPLOYER CONTRIBUTIONS
## (AMOUNTS IN THOUSANDS)
## JUNE 30, 2014

**Schedule of Employer Contributions**

(Amounts in 000's)

| Fiscal Year Ending* | Actuarially Determined Contribution** | Actual Fiscal Year Contribution | Deficiency (Excess) | Covered Payroll | Contribution as % of Payroll |
|---|---|---|---|---|---|
| 6/30/2014 | $ 1,164 | $ 1,164 | $ - | n/a | n/a |
| 6/30/2013 | - | - | - | n/a | n/a |
| 6/30/2012 | 9,079 | 46,600 | (37,521) | n/a | n/a |
| 6/30/2011 | 8,036 | 8,036 | - | n/a | n/a |
| 6/30/2010 | 4,982 | 4,982 | - | n/a | n/a |
| 6/30/2009 | 956 | 956 | - | n/a | n/a |
| 6/30/2008 | 3,194 | 3,194 | - | n/a | n/a |
| 6/30/2007 | 3,839 | 3,839 | - | n/a | n/a |
| 6/30/2006 | 1,427 | 1,427 | - | n/a | n/a |
| 6/30/2005 | 8,407 | 26,293 | (17,886) | n/a | n/a |

*Source is the June 30, 2014 actuarial valuation prepared by System Actuary, Bartel Associates.*

** GASB 67 requires this information be reported for 10 years.*

*** As required by applicable Contribution Agreements with the City.*

**PASADENA FIRE AND POLICE RETIREMENT SYSTEM**
**SCHEDULE OF INVESTMENT RETURNS**
**JUNE 30, 2014**

| | 2014* |
|---|---|
| Annual money-weighted rate of return, net of investment expense | 15.4% |

*Source is the June 30, 2014 Investment Performance Review provided by System investment Advisor, Wurts Associates.*
**GASB 67 requires this information be reported for 10 years. Additional years will be displayed as they become available.*

## NOTE 1 – SCHEDULE OF CHANGES IN THE EMPLOYER NET PENSION LIABILITY

The total liability contained in this section was provided by the System's actuary, Bartel Associates. The net pension liability is measured as the total pension liability less the amount of the fiduciary net position of the System.

## NOTE 2 – SCHEDULE OF EMPLOYER CONTRIBUTIONS

The required employer contribution and percent of those contributions actually made are presented in this section.

## NOTE 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 System's actuary and adopted by the Board. Additional information as of the latest actuarial valuation follows:

| | | |
|---|---|---|
| Valuation Date/Measurement Date | June 30, 2014 | |
| Actuarial Cost Method | Entry Age Normal Cost Method | |
| Geometric Real Rates of Return | Based on CalPERS 2013 10-year Expected Geometric Returns | |
| | Global Equity | 5.00% |
| | Fixed Income | 0.74% |
| | TIPS | 0.20% |
| | Hedge Funds | 3.14% |
| | Real Estate | 4.25% |
| | Cash Equivalents | 0.00% |
| Actuarial Assumptions | Discount Rate | 6.0% |
| | Salary Scale | No active employees |
| | Cost of Living | 3.0% |
| Mortality | CalPERS 1997-2007 Experience Study, Projection Scale AA | |

# OTHER SUPPLEMENTARY INFORMATION

**PASADENA FIRE AND POLICE RETIREMENT SYSTEM**
**OTHER SUPPLEMENTARY INFORMATION**
**REVENUES BY SOURCE AND EXPENSES BY TYPE**
**(AMOUNTS IN THOUSANDS)**

**REVENUES BY SOURCE**

| Fiscal Year | Employee Contributions | Employer Contributions | Gross Investment Income (Loss) | Total |
|---|---|---|---|---|
| 2014 | $ - | $ 1,164 | $ 21,643 | $ 22,807 |
| 2013 | - | - | 16,004 | 16,004 |
| 2012 | - | 46,600 | 2,279 | 48,879 |
| 2011 | - | 8,036 | 19,970 | 28,006 |
| 2010 | - | 4,982 | 15,278 | 20,260 |
| 2009 | 24 | 956 | (23,160) | (22,180) |
| 2008 | 24 | 3,194 | (9,992) | (6,774) |
| 2007 | 20 | 3,839 | 22,343 | 26,202 |
| 2006 | 57 | 1,427 | 14,398 | 15,882 |
| 2005 | 82 | 26,293 | 13,635 | 40,010 |

**EXPENSES BY TYPE**

| Fiscal Year | Benefits | Administrative Expenses | Investment Expenses | Total |
|---|---|---|---|---|
| 2014 | $ 14,140 | $ 296 | $ 339 | $ 14,775 |
| 2013 | 14,322 | 271 | 374 | 14,967 |
| 2012 | 14,148 | 287 | 243 | 14,678 |
| 2011 | 14,382 | 242 | 365 | 14,989 |
| 2010 | 14,975 | 246 | 332 | 15,553 |
| 2009 | 14,898 | 211 | 466 | 15,575 |
| 2008 | 14,864 | 301 | 407 | 15,572 |
| 2007 | 14,572 | 257 | 492 | 15,321 |
| 2006 | 14,190 | 234 | 561 | 14,985 |
| 2005 | 13,969 | 229 | 457 | 14,655 |