



SUMMARY ANNUAL FINANCIAL REPORT

for the fiscal year ending
12.31.2017

1134 Municipal Way
Lansing, Michigan 48917

800.767.MERS (6377)
www.mersofmich.com

ABOUT THIS REPORT

This report provides a summary of the MERS Comprehensive Annual Financial Report (CAFR) for the fiscal year which ended December 31, 2017. The CAFR is prepared in accordance with Generally Accepted Accounting Principles (GAAP) and is subject to external audit. This Summary Annual Financial Report is also prepared in accordance with GAAP. The 2017 CAFR contains more detailed information and can be obtained by contacting MERS:

Website:

www.mersofmich.com

By mail:

Municipal Employees' Retirement System of Michigan
1134 Municipal Way
Lansing, MI 48917

By phone:

800.767.MERS (6377)

The financial statements were audited by Plante & Moran, PLLC.

CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING



MERS received the Award for Outstanding Achievement in Popular Annual Financial Reporting from the Government Finance Officers Association for the 2016 Summary Annual Financial Report. This marks the 14th consecutive year MERS has received this honor.

AN INDEPENDENT ELECTED BOARD

MERS is governed by an independent, unpaid board committed to fairness, transparency and accountability for our customers. Our board adheres to strong conflict of interest provisions and best fiscal practices making us a reliable fiduciary agent and a go-to expert for retirement security in Michigan.

Three Officer Members:

Officers of a participating municipality, elected by membership

Three Employee Members:

Non-officers of a participating municipality, elected by membership

Two Expert Members:

With experience in retirement systems or investment management, appointed by the Board

One Retiree Member:

Retiree of the system, appointed by the Board



MERS Retirement Board

is responsible for administration of the system with **fiduciary responsibility** for the investment of assets and oversight.

MERS OFFICERS



From left to right:

Carrie Lombardo, Chief Strategic and External Affairs Officer

Denise Boucke, Chief Customer Service Officer

Chris DeRose, Chief Executive Officer

Jeb Burns, Chief Investment Officer

Leon Hank, Chief Financial Officer

MERS RETIREMENT BOARD



Back row (standing left to right): Dale Feldpausch, James Wiersma, Jason Sarata, Michael Brown, Tina Butler

Front row (sitting): Amy Deford, John Ogden, Michael Gilmore, Randy Girard

LETTER OF TRANSMITTAL, MAY 16, 2018

We are pleased to submit the Summary Annual Financial Report for the Municipal Employees' Retirement System (MERS) of Michigan for the fiscal year ending December 31, 2017.

This year, MERS completed the first year of our four-year strategic plan driven by our vision to deliver superior value to our customers by:

- 1) Achieving a deeper understanding of customer needs and connection with them.
- 2) Proactively partnering with employers by providing options that help meet their unique needs.
- 3) Consistently delivering services through intuitive processes and systems.
- 4) Significantly increasing resources and awareness that help participants improve financial wellness to be ready for retirement.

Supported by strategic business plan projects and measured by meaningful data on an ongoing basis, MERS aims to build on past successes, respond to customer feedback, and establish direction for continual improvement. More specifically, performance outcomes included an increase in satisfaction of employers and participants from 85% to 92%, and 85% to 93% respectively. There was a dedicated focus on building awareness of MERS resources and actions participants can take to improve their financial wellness. In addition, we established performance standards and promoted user-centric processes to consistently deliver service through intuitive, streamlined processes to customers.

MERS continues to work to manage costs, maximize benefit options, and develop responsible, alternative funding approaches for employers. One key initiative was to continue to assist our customers in managing their unfunded liabilities, recognizing there is no one-size-fits-all approach. MERS has expanded its toolbox of options for municipalities to proactively address their plans, and we're proud of the fact that over the last six years, 75% of MERS members have taken voluntary steps to reduce unfunded liabilities. This approach aligns the unique nature of each municipality with the appropriate strategies to address their specific needs.

MERS Profile

MERS is a statutory public corporation that serves members across the state of Michigan. We are one of the largest, most established, and successful shared services stories in Michigan, providing administration, investment expertise, fiduciary responsibility, and oversight for benefit plans. Our approach to efficiently managing retirement and other post-employment plans allows local governments to focus on their core services, leaving day-to-day plan administration and long range management to us. Services we provide include: plan governance, on-staff auditor, legal counsel, actuarial services, financial management, fiduciary responsibility, information technology support, legislative advocacy, administration of benefits, and investments. The MERS Retirement Board (Board) serves as the fiduciary of the funds and has oversight responsibilities.

Financial Summary

In 2017, MERS enhanced our oversight practices and continued to improve the efficiency of MERS investments along with returns to mitigate the low return environment. For the second year in a row, MERS had robust investment returns for the MERS Defined Benefit (DB) Portfolio. This year, the portfolio gained 13.4% (gross of fees). More information regarding our investment management performance, policies and processes are found in the Investments Section. Investment returns above the 7.75% actuarial assumption helps strengthen DB plans and reduces retirement costs paid by employers and employees.

MERS also grew its net position held for members to a new record level of \$11.4 billion. The most significant factor in that

growth was net revenue of \$2.3 billion (\$1.4 billion from investment returns). Strong cost control measures helped MERS hold its administrative costs to \$19.2 million, consistent with last year, and within comparable costs all the way back to its 2009 spending level. Lower administrative costs also have a positive impact on all our plans.

As an indicator of how municipalities are more aggressively addressing their other post-employment benefit (OPEB) obligations, MERS experienced its most significant growth in the Health Care Savings Program and Retiree Health Funding Vehicle, where net plan assets grew by 25% and 20% respectively. The total asset increase for these two programs for 2017 is over \$187 million.

We continue to partner with all municipalities in helping them set fiscal goals and discussing options to find the programs and provisions that best fit each municipality's unique needs. There are 730 municipalities within MERS Defined Benefit and Hybrid Plans, which encompasses 2,723 divisions with unique benefit designs. Overall, 29% of municipalities have one or more divisions where new hires have either a hybrid plan or a lower tier defined benefit. About 24% of municipalities have one or more divisions where new hires have a defined contribution plan. There were also 176 divisions that increased cost sharing to their employees. In 2017, almost half of our employers made voluntary contributions to their plan, contributing an additional \$149 million to help increase funding levels. These efforts helped strengthen the financial condition of all these plans. In addition, new municipalities joining the MERS system brought in an extra \$48 million.

Respectfully submitted,



Chris DeRose
Chief Executive Officer



Leon E. Hank, CPA
Chief Financial Officer

FINANCIAL HIGHLIGHTS

The following financial highlights occurred during the year ended December 31, 2017:

- Total fiduciary net position for the Defined Benefit Plan, Defined Contribution Plan, Health Care Savings Program, Retiree Health Funding Vehicle, 457 Program, and Investment Services Program increased by 13%, primarily due to investment gains for the year. MERS finished the year with \$11.4 billion in net fiduciary position, the highest level in our history.
- Defined Benefit investment returns saw a gain of 13.2% net of investment expenses for the year. The 30-year return was 8.51%, which is above the long-term target of MERS expected investment rate of return of 7.75%.
- Contribution revenue increased by 1% from \$851 million in 2016 to \$858 million in 2017. This increase was largely due to an increase in employer contributions compared to the previous year.
- Total annual benefits, transfers, and withdrawals decreased by \$104 million for a total of \$909 million. This decrease was due to a withdrawal in 2016 of \$108 million for a Defined Benefit employer who privatized and terminated its plan with MERS.

Comparison Statement of Fiduciary Net Position (Dollars in Thousands)

	Year Ended December 31, 2017	Year Ended December 31, 2016	Increase (Decrease) Amount	Increase (Decrease) Percent
Assets				
Cash and Short-Term Investments	\$12,766	\$131,920	\$(119,154)	-90%
Receivables	367,227	214,316	152,911	71%
Interfund Receivables	136	81	55	68%
Loans	5,774	5,063	711	14%
Investments, at fair value	11,315,059	9,863,926	1,451,133	15%
Invested Securities Lending Collateral	528,514	750,384	(221,870)	-30%
Other Assets/Prepays	695	651	44	7%
Net Capital Assets	15,913	15,126	787	5%
Total Assets	12,246,084	10,981,467	1,264,617	12%
Deferred Outflow of Resources				
Outflows Related to Pension	4,288	5,130	(842)	100%
Liabilities				
Purchase of Investments	324,919	171,383	153,536	90%
Securities Lending Collateral	528,610	750,429	(221,819)	-30%
Administrative/Investment Costs/Reserves	8,633	10,762	(2,129)	-20%
Interfund Payables	136	81	55	68%
Total Liabilities	862,298	932,655	(70,357)	-8%
Net Position Restricted for Pension and Health Benefits and Investment Accounts Held for Others	\$11,388,074	\$10,053,942	\$1,334,132	13%

The Statement of Fiduciary Net Position summarizes what MERS owns and what it owes as of the end of the fiscal year.

- Administrative expenses remained level at \$19 million while MERS grew significantly and brought in 202 new municipal programs. MERS has continued to keep costs down through the growth of our pool and strong ongoing budgeting and cost-control measures.
- Investment expenses totaled \$14 million, a decrease from the previous year. Most of these expenses are related to investment manager fees. The decrease in investment manager expense was partly due to bringing in additional assets to be managed in-house by MERS Office of Investments at a lower cost.
- MERS' most recent actuarial valuation, dated December 31, 2016, showed 401 of MERS' 720 Defined Benefit municipalities are funded 70% or better, with 66 municipalities over 100% funded.
- The difference between MERS' actuarial and fair value assets declined from last year, as the actuarial calculation for 2017 is 101% of the fair value of assets as calculated by the actuaries (the ratio was 108% as of December 31, 2016). Total Defined Benefit Plan actuarial assets and fair value of assets were valued at \$9,545,649,179 billion and \$9,438,790,673 billion respectively at December 31, 2017.

Comparison Statement of Changes in Fiduciary Net Position (Dollars in Thousands)

	Year Ended December 31, 2017	Year Ended December 31, 2016	Increase (Decrease) Amount	Increase (Decrease) Percent
Additions				
Contributions	\$858,228	\$851,270	\$6,958	1%
Investment Net Income (Loss) Investing Activities	1,404,789	1,000,473	404,316	40%
Investment Net Income-Securities Lending	3,663	5,073	(1,410)	-28%
Miscellaneous Income	55	101	(46)	-46%
Total Additions	2,266,735	1,856,917	409,818	22%
Deductions				
Benefits/Transfers and Withdrawals	909,116	1,013,016	(103,900)	-10%
Forfeitures, Miscellaneous	15		15	100%
Special Litigation Expense	4,250		4,250	100%
Administrative Expense	19,222	19,143	79	0%
Total Distributions	932,603	1,032,159	(99,556)	-10%
Net Increase/Decrease	1,334,132	824,758	509,374	62%
Net Position-Restricted for Pension and Health Benefits and Investment Accounts Held for Others				
Balance Beginning of Year	10,053,942	9,229,184	824,758	9%
Balance End of Year	\$11,388,074	\$10,053,942	\$1,334,132	13%

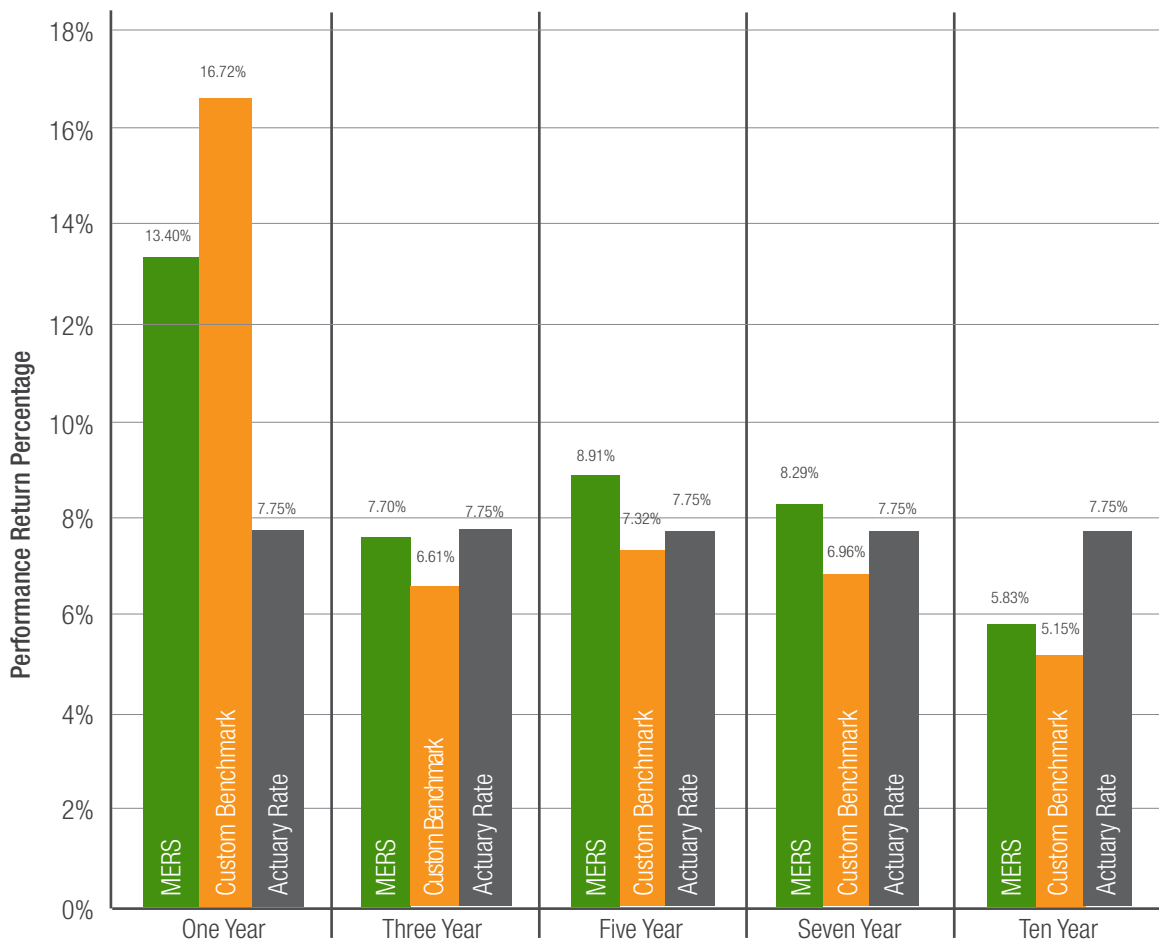
The Statement of Changes in Fiduciary Net position summarizes the flow of money in and out of the fund throughout the fiscal year. The primary uses of MERS assets are the payments of benefits to participants and their beneficiaries, refunds to terminated participants, and the cost of administering the system.

INVESTMENT OBJECTIVES AND ACTIVITY

In conformity with PERSIA, the primary goal of MERS' investment program is to grow assets at a rate which, when coupled with employer and employee contributions, satisfies promised benefits to MERS members. To achieve this objective, the Investment Committee allocates MERS' assets with a strategic, long-term perspective and a high degree of prudence to reduce risk by:

- Exceeding the actuarial investment assumption on a long-term basis, which is currently 7.75% annually;
- Maintaining adequate liquidity to pay promised benefits;
- Adopting a strategic asset allocation plan that reflects current and future liabilities, minimizes volatility, and maximizes the long-term total rate of return;
- Minimizing the costs associated with the implementation of the asset allocation through the efficient use of internal and external resources;
- Maintaining above median peer rankings for the 10-year time period; and
- Exceeding the return of the Fund's Policy Benchmark. The Policy Benchmark currently consists of 45% Russell 3000, 25% Bloomberg Barclays Global Aggregate Bond Index, 20% MSCI ACWI IMIex-US, and 10% Bloomberg Barclays Global Aggregate ex US.

Performance Versus Custom Benchmarks as of December 31, 2017 (gross of fees)



MERS INVESTMENT HIGHLIGHTS

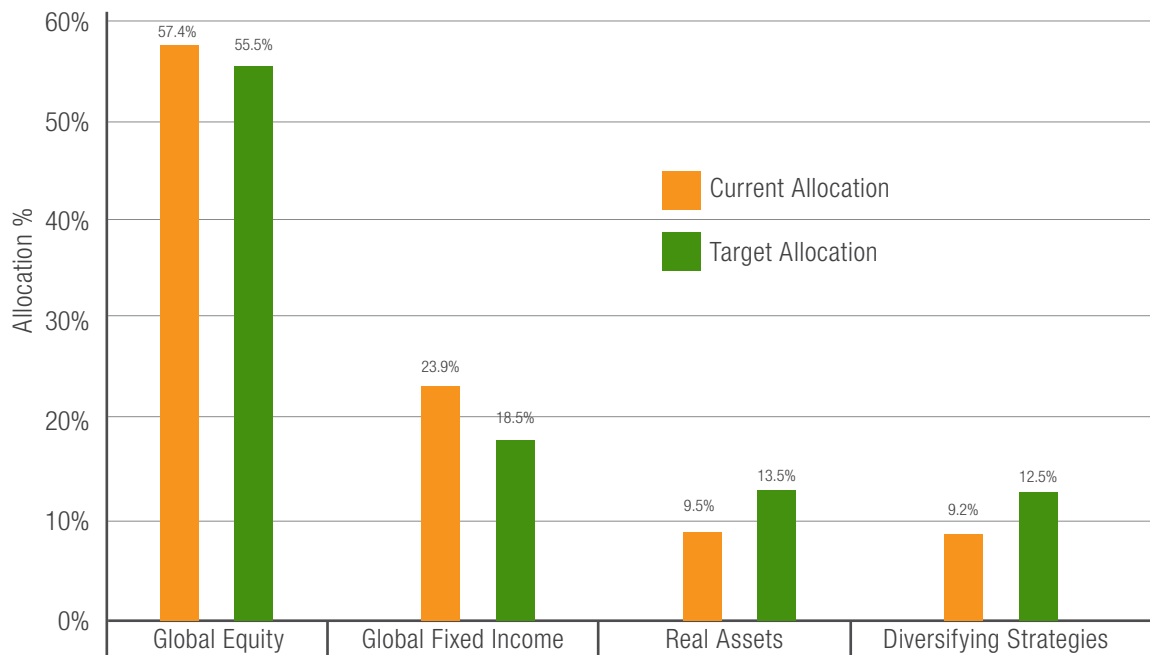
- MERS Defined Benefit Portfolio returned 13.40% gross of fees for the year, underperforming its policy benchmark by 3.33%. The 5-year return of 8.91% outperformed the policy benchmark by 1.59% on an annualized basis.
- The Office of Investments completed the implementation of the asset allocation changes set forth in the 2016 Asset Allocation Study to meet goals for long-range investment growth and stability.
- The target asset allocation breakdown is shown below:

Global Equity	55.5%
Global Fixed Income	18.5%
Real Assets	13.5%
Diversifying Strategies	12.5%

- At the broad asset class level, absolute returns gross of investment fees for the year were as follows:

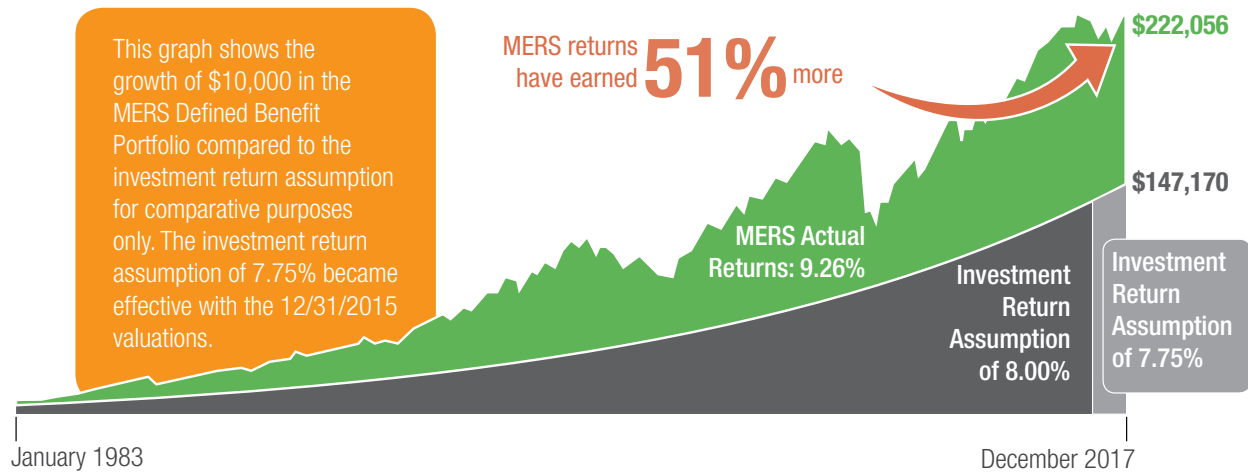
Global Equity	20.39%
Global Fixed Income	4.73%
Real Assets	1.74%
Diversifying Strategies	9.10%

Current Asset Allocation versus Target Allocation as of December 31, 2017



A TRACK RECORD OF SUCCESS

As retirement plans operate over long-term time horizons, it's important to focus on long-term rates rather than any single year. The investment return assumption of 7.75% is projected over the lifetime of the participants covered in the plan, typically more than 30 years. For municipalities that wish to project a more conservative approach, MERS provides tools to do so within our annual valuation reports.



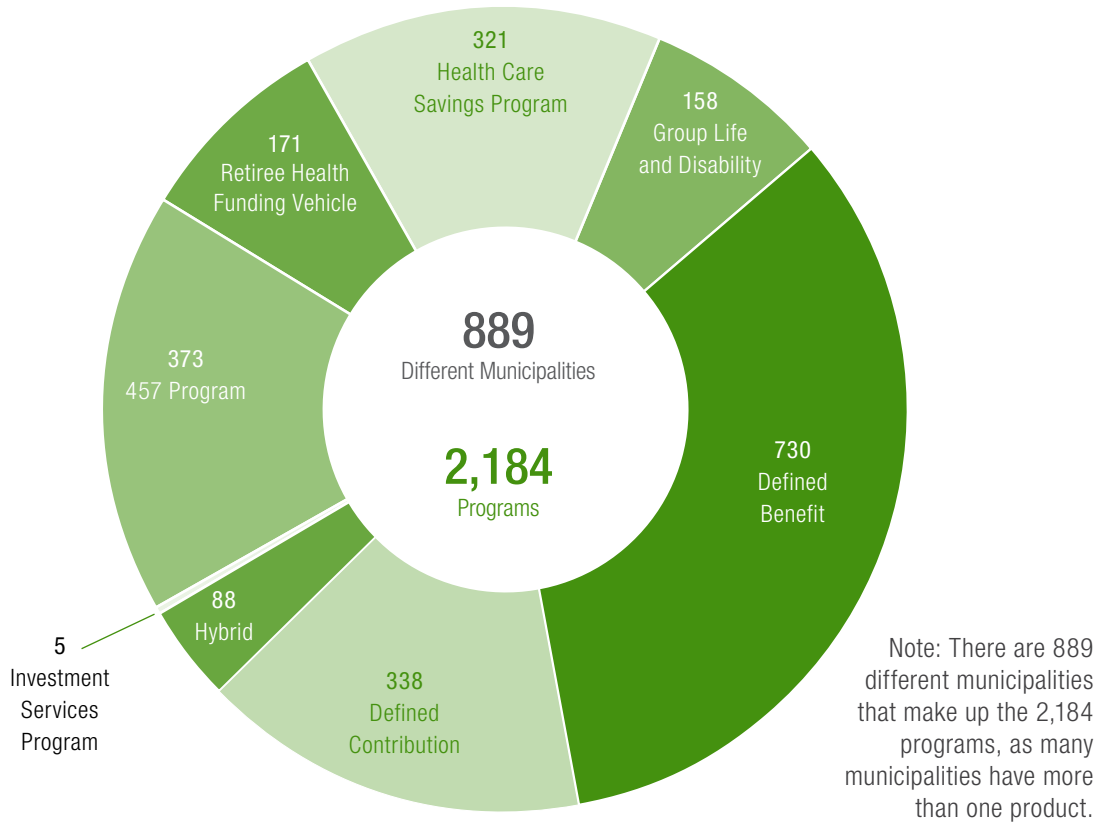
Year-by-Year Returns (35 years: 1983-2017)

Year	Rate of Return	Year	Rate of Return	Year	Rate of Return
2017	13.40%	2005	6.78%	1993	9.67%
2016	11.10	2004	14.90	1992	8.05
2015	-0.85	2003	24.72	1991	22.14
2014	6.68	2002	-8.34	1990	2.94
2013	15.00	2001	-1.91	1989	19.10
2012	11.39	2000	-2.76	1988	11.20
2011	2.30	1999	17.01	1987	5.51
2010	14.43	1998	14.20	1986	13.55
2009	17.31	1997	14.43	1985	24.33
2008	-24.79	1996	12.68	1984	9.33
2007	8.58	1995	23.95	1983	10.64
2006	13.61	1994	0.52		

Annualized 35-year rate of return for MERS Defined Benefit: 9.26%

Performance numbers on this page are gross of fees.

MERS Participating Municipalities as of December 31, 2017



MERS Participants as of December 31, 2017

	Defined Benefit	Defined Contribution	Hybrid	Health Care Savings Program	457
Active	31,987	12,093	2,784	14,924	3,302
Deferred	9,056	NA	194	NA	NA
Retired	39,782	NA	70	NA	NA
Contributions not Vested	11,965	NA	7	NA	NA
Terminated	NA	4,726	NA	5,226	438
Product Totals	92,790	16,819	3,055	20,150	3,740
Total MERS Accounts*					<u>136,554</u>
Total MERS Participants**					<u>113,401</u>

* Total MERS Accounts represents the total number of accounts within MERS; individuals may be represented multiple times across categories.

** Total MERS Participants represents the number of unique individuals that have a liability in a program. At least one of the individual's employments fell into the following categories: Active Status, Retired Status, Terminated Status Defined Benefit vested, Terminated Status Defined Benefit not vested but has a contribution balance, Terminated Status Hybrid vested, Terminated Status Hybrid not vested but has a contribution balance, Terminated Status Defined Contribution with a contribution balance, or Terminated Status Health Care Savings Program with a contribution balance.

INVESTMENT MANAGERS

Acadian Asset Management Inc.
Adveq Management US Inc.
Alpine Lake Capital Partners, LLC (Barings LLC)
AlpInvest Partners
Angelo, Gordon & Co.
ARA Asset Management Limited
Blackstone Alternative Asset Management, LP
Brookfield Asset Management
Brookwood Financial Partners, LLC
C.S. McKee, LP
Colony Capital, LLC
Comvest Partners
Connor, Clark, & Lunn Investment Management
Consilium Investment Management
Cromwell Property Group
Domain Capital Advisors, LLC
ElmTree Funds, LLC
Exeter Property Group, LLC
Fortress Investment Group, LLC
Frontier Market Asset Management, LLC
Gerchen Keller Capital, LLC (Burford Capital)
Grantham, Mayo, Van Otterloo & Co. LLC
Grosvenor Capital Management, LP
H/2 Capital Partners
Hancock Natural Resource Group, Inc.
Harbert Management Corporation
Hemisfério Sul Investimentos SA
IL&FS Capital Advisors Limited
Intercontinental Real Estate Corporation
J.P. Morgan Asset Management

Janus Capital Management, LLC
Kennedy Capital Management Inc.
LaSalle Investment Management
LMCG Investments, LLC
MC Credit Partners, LP
Mellon Capital Management Corporation
Mesirow Private Equity Advisors, Inc.
Metropolitan Real Estate
Michigan eLab Capital Partners, LP
Miravast Asset Management, LLC
Mountain Pacific Group, LLC
Napier Park Global Capital
Oak Hill Advisors, LP
Oak Street Real Estate Capital, LLC
Oberland Capital Management, LLC
Och-Ziff Real Estate Advisors, LP
Orchard Global Asset Management, LLP
Pioneer Asset Management SA
Polunin Capital Partners Limited
Punch & Associates
Rialto Capital Management, LLC
SPI Strategies, LLC
Square Mile Capital Management, LLC
Starwood Capital Group
Terra Partners Asset Management
The Electrum Group, LLC
The Townsend Group
Verdant *f*
William Blair & Company



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This publication contains a summary description of MERS benefits, policies or procedures. MERS has made every effort to ensure that the information provided is accurate and up to date (as of 06/07/18). If this publication conflicts with the relevant provisions of the Plan Document, the Plan Document Controls. MERS, as a governmental plan, is exempted by state and federal law from registration with the SEC. However, it employs registered investment advisors to manage the trust fund in compliance with Michigan Public Employee Retirement System Investment Act. Past Performance is not a guarantee of future returns. Please make independent investment decisions carefully and seek the assistance of independent experts when appropriate.

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