

MENDOCINO COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
(A Pension Trust Fund and Component Unit of the County of Mendocino, California)

**COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE FISCAL YEARS ENDED JUNE 30, 2013 AND 2012**



***Mendocino County Employees’
Retirement Association***

A Pension Trust Fund and Component Unit of the County of Mendocino, California

***Comprehensive Annual
Financial Report***

For the fiscal years ended June 30, 2013 and 2012

Prepared by: RICHARD A. WHITE, JR.
Retirement Administrator

MCERA
625-B Kings Court
Ukiah, California 95482
(707)463-4328
www.co.mendocino.ca.us/retirement/

Mendocino County Employees' Retirement Association "MCERA"

MCERA is a retirement system, organized under the County Employees Retirement Law of 1937, which provides retirement, disability, and death benefits to the employees, retirees and former employees of the County of Mendocino, the Mendocino County Superior Court and the Russian River Cemetery District.

MCERA's principal responsibilities include: management of the trust fund; delivery of retirement, disability and death benefits to eligible members; administration of cost-of-living programs; and general assistance in retirement and related benefits.

Mission Statement

To provide members and their beneficiaries with sustainable benefits and exceptional service through professional plan administration and prudent investment practices.

Goals

- Enhance communications and customer service provided by the Association
- Increase the effectiveness of internal operations
- Establish optimal board governance
- Explore ways to ensure prudent management of contributions and investment of retirement fund assets

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Introductory Section



Richard A. White, Jr.
Retirement Administrator



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MENDOCINO COUNTY
EMPLOYEES' RETIREMENT ASSOCIATION
625-B KINGS COURT
UKIAH, CALIFORNIA 95482-5027

LETTER OF TRANSMITTAL

March 11, 2014

Board of Retirement
Mendocino County Employees' Retirement Association
625-B Kings Court
Ukiah, CA 95482

Dear Board Members:

It is with great pleasure that we submit the Comprehensive Annual Financial Report (CAFR) of the Mendocino County Employees' Retirement Association (MCERA or System) as of and for the fiscal year ending June 30, 2013, the System's 65th year of operation.

The following section provides an overview and analysis of the Mendocino County Employees' Retirement Association (MCERA) financial activities for the year ended June 30, 2013. We encourage readers to take into account the information presented here in conjunction with additional information we have furnished in the financial statements.

MCERA

MCERA provides service retirement, disability, death and survivor benefits and is administered in accordance with the County Employees Retirement Law of 1937 (Government Code Section 31450, et seq.) Pursuant to certain provisions of the County Employees Retirement Law, MCERA is a multi-agency public employees' retirement system, established by the County of Mendocino on January 1, 1948, and is an independent district within the County of Mendocino, with a separate operating budget and professional staff.

The California Constitution gives the Board of Retirement (Board) plenary authority over the administration of the system, which includes administering plan benefits and managing the assets. The Board of Retirement and MCERA staff members are committed to act for the exclusive benefit of the plan and its participants, manage the assets of the plan prudently and administer benefits with impartiality.

Introductory Section

To fulfill this mandate, MCERA employs a skilled professional staff and independent consultants that operate under a system of governance, operational and fiduciary policies and procedures.

Participating agencies in MCERA include the County of Mendocino, the Superior Court of Mendocino and the Russian River Cemetery District.

FINANCIAL HIGHLIGHTS

Net assets available for benefits increased to \$383.2 million which reflects an increase of 11.80% in net assets during Fiscal Year 2012-13. Additions to plan assets for the fiscal year were \$67.9 million. This was comprised of \$ 14.3 million of employer contributions, \$ 4.7 million of member contributions and a net investment gain of \$ 48.9 million. Expenses (deductions in plan assets) for the year were \$27.4 million which included \$26.6 million in benefit payments to retirees and beneficiaries and \$0.8 million in administrative expenses.

ADMINISTRATIVE EXPENSES

The Board of Retirement approves MCERA's annual budget. The County Employees Retirement Law (CERL) limits MCERA's annual administrative expenses, excluding the costs of administration for computer software and hardware and computer technology consulting services (IT costs), to twenty-one hundredths of one percent (0.21%) of MCERA's actuarial accrued liability or \$2 Million, whichever is greater. The Board of Retirement policy is that administrative expenses incurred in any year will not exceed twenty-one hundredths of one percent (0.21%) of MCERA's actuarial accrued liability, unless authorized by a separate vote of the Board of Retirement.

MCERA's actual administrative expense was \$829,999 which represented 0.17% of MCERA's actuarial accrued liability or 41.5% of the \$2 million statutory cap.

MANAGEMENT RESPONSIBILITY OF FINANCIAL REPORTING

MCERA management is responsible for establishing a system of internal control to safeguard assets and for the complete and fair presentation of the financial information in accordance with generally accepted accounting principles (GAAP) in the United States. To the best of our knowledge, the enclosed data is accurate in all material respects and is reported in a manner designed to fairly present the financial position and operating results of MCERA.

MAJOR INITIATIVES AND SIGNIFICANT EVENTS

Several major initiatives were undertaken during the year including:

- The Board of Retirement engaged in a strategic planning session which led to the adoption of a mission statement, core values, goals and objectives for MCERA.
- Implemented the initiatives included in the pension reform legislation known as PEPR (California Public Employee' Pension Reform Act of 2013).
- Selected a service provider to install a pension administration system.
- Enhanced Board governance with the adoption of various charter and policies.
- Adopted significant revisions to the disability application procedures.
- Adopted changes to the actuarial funding policy.

ACCOUNTING SYSTEMS AND REPORTS

MCERA management is responsible for establishing a system of internal control to safeguard assets and for the presentation of the accompanying basic financial statements. Because the cost of a control should not exceed the benefits to be derived, the objective is to provide reasonable, rather than absolute assurance, that the financial statements are free from any material misstatements. Internal control, no matter how well designed, implemented and conducted, can provide only reasonable assurance to management and the board of directors of the achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all systems of internal control. These include realities that human judgment in decision making can be faulty, external events outside the organization's control may arise, and breakdowns can occur because of human failures such as making errors. Additionally, controls can be circumvented by two or more people colluding, and because management can override the system of internal control. Oversight is provided by MCERA Audit and Budget Committee. Gallina, LLC audited the accompanying basic financial statements and related disclosures.

The CAFR was prepared in accordance with GAAP and reporting guidelines set forth by the Governmental Accounting Standards Board (GASB) and the County Employees Retirement Law of 1937. GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of management discussion and analysis (MD&A).

This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. MCERA's MD&A can be found immediately following the independent auditor's report.

INVESTMENT AND ECONOMIC SUMMARY

In accordance with state constitutional mandates, the Board adopts a strategic asset allocation policy designed to ensure diversification among asset classes and achieve MCERA's long-term investment objectives. Although MCERA invests on a long term horizon, short term returns are important to keep in mind.

The investment return for the year ending June 30, 2013 was 14.52% which was ahead of the benchmark by 2.23%. The returns were 11.36%, 5.71% and 5.95% for three, five and seven year periods ending June 30, 2013, respectively.

The Association maintains an assumed net rate of investment return of 7.75% per year. The rate of return on MCERA's investment portfolio is an integral component of the annual additions to the pension plan as total investment income is typically the largest contributor to the plan's annual additions to retirement plan assets.

FUNDED STATUS AND ACTUARIAL REPORTING

MCERA maintains a funding goal to establish contributions that fully fund the System's liabilities, and that, as a percentage of payroll, remain as level as possible for each generation of active members. Actuarial valuations are performed annually with actuarial experience investigations conducted triennially in accordance with state statute. The use of realistic assumptions is important in maintaining the necessary funding while paying promised benefits. Each year the actual experience of the System is compared to our assumptions and the differences are studied to determine whether changes in the contribution requirements are necessary. In addition, triennially, the actuarial experience investigation is undertaken to review the actuarial assumptions and compare the actual experience during the preceding three year period with that expected under those assumptions.

In December 1996, the County issued its Taxable Pension Obligation Bonds in the aggregate principal amount of \$30,720,000. In December 2002, the County issued its Taxable Pension Obligation Bonds, Refunding Series 2002 in the aggregate principal amount of \$91,945,000 to defease a portion of the 1996 POBs and to provide funds to allow the County to refund its then current unfunded actuarial accrued liability for retirement benefits for County employees. The County has contributed to the Association an aggregate amount of \$106,411,000 from the issuance of the 1996 POBs and the 2002 POBs to reduce the UAAL. As of June 30, 2013, the 2002 POBs are outstanding in the principal amount of \$76,000,000 with annual payment requirements of approximately \$8,000,000 due in July of each year until July 2026.

In the June 30, 2013 valuation, the ratio of actuarial value of assets to the actuarial value of liabilities was 74.2% which was an increase from the prior year's valuation funded ratio of 74.1%. The Association's unfunded actuarial liability (UAAL) as of June 20, 2013 was \$131,684,255. As of June 30, 2013, there are 26 years remaining in the declining 30-year amortization period of the UAAL.

The aggregate employer rate calculated in this valuation increased to 26.28% of payroll from 25.48% in last year's valuation. The aggregate employee rate increased to 9.62% of payroll from 9.60% in last year's valuation. The aggregate rate as of June 30, 2012 was recalculated for the current year actuarial valuation report which indicated that the employer rate was 25.48% and the aggregate employee rate was 9.60%. Thus, using the recalculated figures, the aggregate employer rate in this valuation increased from 26.28% of payroll from 25.48% in last year's valuation and the aggregate employee rate increased to 9.62% of payroll from 9.60% in last year's valuation.

ACKNOWLEDGEMENTS

I would like to take this opportunity to thank the members of the System for their continued confidence in MCERA during the past year and the Board of Retirement for its dedicated effort in supporting the System throughout this past year. Finally, I would like to thank the consultants, professional service providers and staff for their commitment to MCERA and their diligent work to assure the System's continued success.

REQUEST FOR INFORMATION

The financial report is designed to provide the MCERA Board of Retirement, our membership, taxpayers, investment managers and creditors with a general overview of MCERA finances and to account for the money it receives. Questions concerning any of the information in this report or requests for additional financial information should be addressed to:

Mendocino County Employees' Retirement Association
625-B Kings Court
Ukiah, CA 95482

Respectfully submitted,



Richard A. White, Jr.
Retirement Administrator



Government Finance Officers Association

**Certificate of
Achievement
for Excellence
in Financial
Reporting**

Presented to

**Mendocino County
Employees' Retirement Association
California**

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

June 30, 2012

A handwritten signature in black ink, reading "Jeffrey R. Egan". The signature is written in a cursive, flowing style.

Executive Director/CEO

**MEMBERS OF THE BOARD OF RETIREMENT
JUNE 30, 2013**

Shari Schapmire, Chair
Treasurer – Tax Collector
County of Mendocino

Lloyd Weer, Vice-Chair
Elected by Active General Membership

Tim Knudsen, Secretary
Elected by Retired Membership

Bob Mirata, Trustee
Appointed by the Board of Supervisors

Randy Goodman, Trustee
Elected by Active General Membership

John McCowen, Trustee and Member, Board of Supervisors
Appointed by the Board of Supervisors

Craig Walker, Trustee
Elected by Active Safety Membership

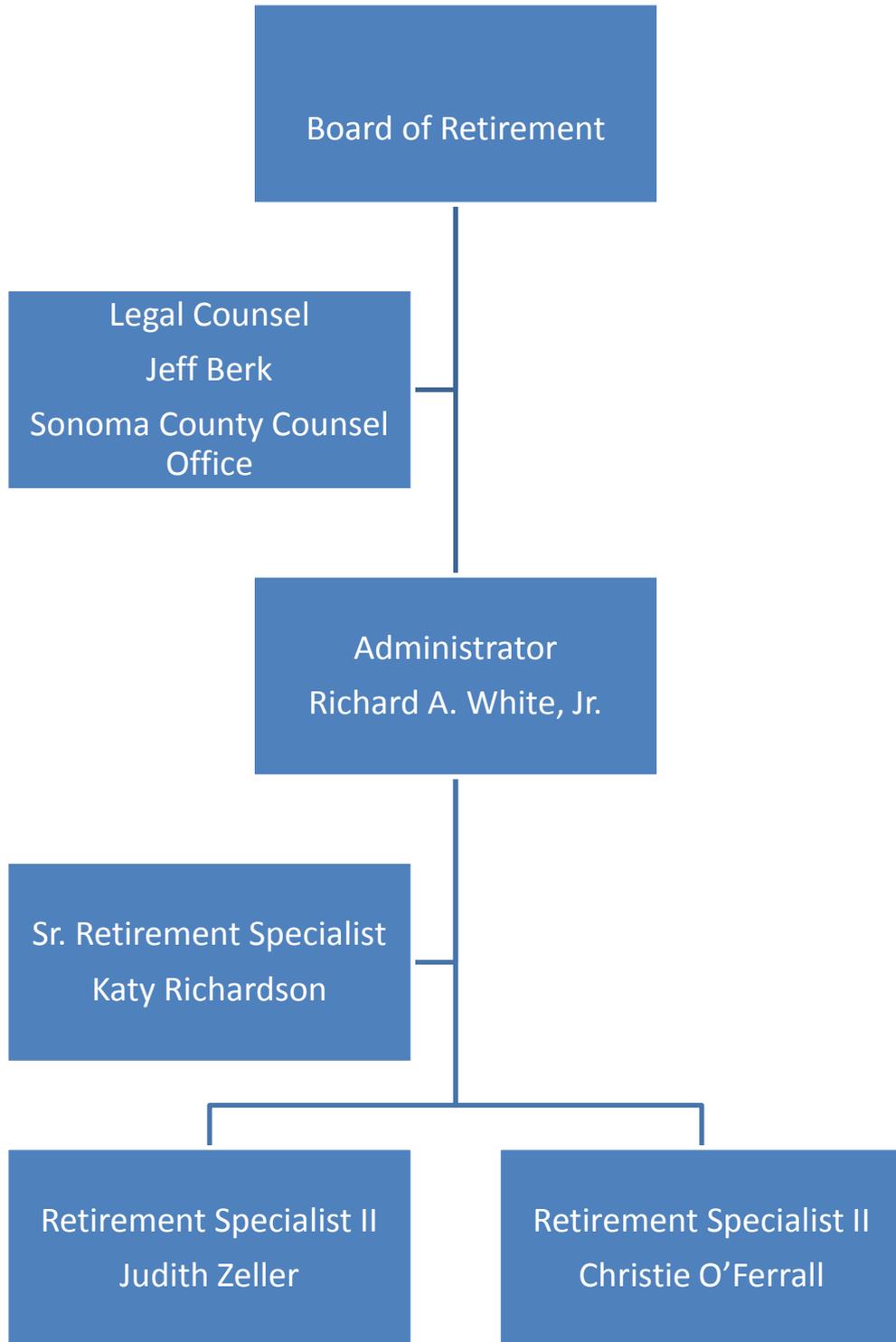
John Sakowicz, Trustee
Appointed by the Board of Supervisors

Ted Stephens, Trustee
Appointed by the Board of Supervisors

Richard Shoemaker, Alternate Trustee
Elected by Retired Membership

Vacant, Alternate Trustee
Elected by the Active Safety Membership

**ORGANIZATION CHART
AS OF JUNE 30, 2013**



**List of Professional Consultants
As of June 30, 2013**

Actuary

The Segal Company

Disability Counsel

Law Office of Tony Graham

Fiduciary Counsel

Manatt, Phelps & Phillips, LLP

Investment Consultant

Callan Associates, Inc.

Independent Auditor

Gallina, LLP

Legal Counsel

County Counsel, County of Sonoma

Tax Counsel

Hanson Bridgett, LLP

Note: List of Investment Managers is located on page 55 of the Investment Section of this report.

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Financial Section





Independent Auditor's Report

To the Board of Retirement
Mendocino County Employees' Retirement Association
Ukiah, California

Report on the Financial Statements

We have audited the accompanying financial statements of Mendocino County Employees' Retirement Association (MCERA), a component unit of the County of Mendocino, which comprise the statement of net position as of June 30, 2013, and the related statement of changes in net position for the year then ended, and the related notes to the financial statements. The prior year summarized comparative information has been derived from MCERA's 2012 financial statements on which our report, dated January 29, 2013, expressed an unqualified opinion.

Management's Responsibility for the Financial Statements

Plan 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 Governmental Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 MCERA'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 MCERA'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.

To the Board of Retirement
Mendocino County Employees' Retirement Association
Independent Auditor's Report

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of MCERA as of June 30, 2013, and the changes its financial status for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Report on Supplemental Information

As described in Note 5, based on the most recent actuarial valuation of the pension plan as of June 30, 2013, MCERA's independent actuary determined that, at June 30, 2013, the value of MCERA's actuarial accrued liability exceeded the actuarial value of its assets by \$132 million. The most recent actuarial value of assets as of June 30, 2013 does not reflect the remaining deferred investment losses that will be recognized in the future.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the Schedule of Funding Progress and the Schedule of Employer Contributions, 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 Governmental Accounting Standards board, who considered 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 an assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The introductory section, other supplemental information in the financial section, the investment, actuarial, and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplemental information in the financial section is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and, certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United State of America. In our opinion, the other supplemental information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory, investment, actuarial, and statistical sections have not been subjected to auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.


Rancho Cordova, California
March 11, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents Management's Discussion and Analysis (MD&A) of Mendocino County Employees' Retirement Association (MCERA or System) financial performance and a summary of MCERA's financial position and activities as of and for the fiscal year ended June 30, 2013. It is a narrative overview and analysis that is presented, in conjunction with the Retirement Administrator's Letter of Transmittal found in the Introductory Section, provides the financial statement reader with a clear picture of the System's overall financial status.

Mendocino County Employees' Retirement Association (MCERA)

MCERA provides service retirement, disability, death and survivor benefits and is administered in accordance with the County Employees Retirement Law of 1937 (Government Code Section 31450, et seq.) Pursuant to certain provisions of the County Employees Retirement Law, MCERA is a multi-agency public employees' retirement system, established by the County of Mendocino on January 1, 1948, and is an independent district within the County of Mendocino, with a separate operating budget and professional staff.

The California Constitution gives the Board of Retirement (Board) plenary authority over the administration of the system, which includes administering plan benefits and managing the assets. The Board of Retirement and MCERA staff members are committed to act for the exclusive benefit of the plan and its participants, manage the assets of the plan prudently and administer benefits with impartiality.

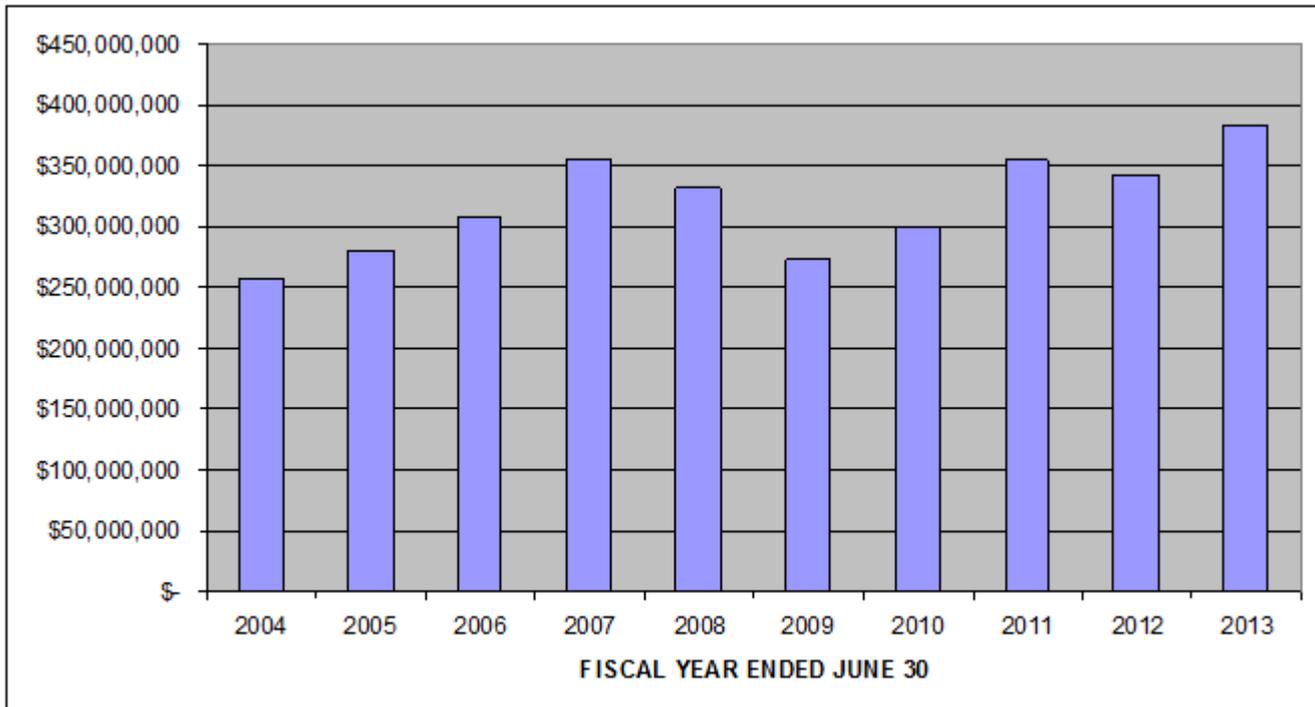
To fulfill this mandate, MCERA employs a skilled professional staff and independent consultants that operate under a system of governance, operational and fiduciary policies and procedures.

Participating agencies in MCERA include the County of Mendocino, the Superior Court of Mendocino and the Russian River Cemetery District.

FINANCIAL HIGHLIGHTS

- MCERA's net assets available for benefits as of June 30, 2013 were \$383 million which was an increase from the prior fiscal year net asset value of \$342 million; an increase of 11.8%.
- Additions to plan assets amounted to \$67.9 million as of June 30, 2013, which represented a 439% increase from the previous fiscal year, and was comprised of \$ 14.3 million of employer contributions, \$ 4.7 million of member contributions and a net investment income gain of \$ 48.9 million.
- Expenses (deductions from plan assets) for the year were \$27.4 million, a 10.15% increase from the previous fiscal year, which included \$26.6 million in benefit payments to retirees and beneficiaries and \$0.8 million in administrative expenses.
- MCERA funding status for the pension plan, as measured by the ratio of actuarial value of assets to the actuarial value of liabilities, increased to 74.2% as of June 30, 2013 from the previous fiscal year funding ratio of 74.1%.

MCERA NET ASSETS HELD IN TRUST FOR PENSION BENEFITS



OVERVIEW OF THE FINANCIAL STATEMENTS

Managements’ Discussion and Analysis serves as an introduction and overview of the MCERA Basic Financial Statements. The Basic Financial Statements and required disclosures are prepared in accordance with accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board (GASB). MCERA’s Basic Financial Statements are comprised of the following:

Statements of Net Position

The Statements of Net Assets Available for Benefits is a snapshot of account balances at year-end. It presents major categories of assets and liabilities at fiscal year-end. The difference between assets and liabilities, “Net Position” represents funds available to pay benefits. The Statements of Net Position includes prior year-end balances for comparative purposes. Increases and decreases in Net Position, when analyzed over time, may serve as an indicator of whether MCERA’s financial position is improving or deteriorating.

Statements of Changes in Net Position

The Statements of Changes in Plan Net Position provides information on the financial activities that increased and decreased Plan Net Position. For comparative purposes, prior year-end balances are also provided. a view of the current year additions to and deductions from the plan. This statement covers the activity over a one-year period of time.

Notes to the Basic Financial Statements

The Notes to the Financial Statements are an integral part of the basic financial statements and provide background and detailed information regarding MCERA’s policies, programs and activities.

Required Supplemental Information

The Required Supplemental Information contains supporting schedule pertaining to MCERA's Pension actuarial methods, assumptions, funded status and annual required contributions.

Other Supplemental Information

Other supplemental information includes schedules pertaining to administrative expenses and investment expenses.

Budget

The Board of Retirement's policy is that administrative expenses incurred in any year will not exceed twenty-one hundredths of one percent (0.21%) of MCERA's actuarial accrued liability, unless authorized by a separate vote of the Board of Retirement.

The Board of Retirement approves MCERA's annual budget. The County Employees Retirement Law (CERL) limits MCERA's annual administrative expenses, excluding the costs of administration for computer software and hardware and computer technology consulting services (IT costs), to twenty-one hundredths of one percent (0.21%) of MCERA's actuarial accrued liability or \$2 million, whichever is greater. Previously, the limit was eighteen hundredths of one percent (0.18%) of MCERA's total assets.

MCERA's actual administrative expense was \$829,999 which represented 0.17% of MCERA's actuarial accrued liability or 41.5% of the \$2 million statutory cap.

Management Responsibility of Financial Reporting

MCERA management is responsible for establishing a system of internal control to safeguard assets and for the complete and fair presentation of the financial information in accordance with generally accepted accounting principles (GAAP) in the United States. To the best of our knowledge, the enclosed data is accurate in all material respects and is reported in a manner designed to fairly present the financial position and operating results of MCERA.

FINANCIAL ANALYSIS

Table #1 and #2 compare and summarize MCERA’s financial activity for the current and prior fiscal years.

**Table #1: MCERA NET ASSETS
As of June 30, 2013 and 2012**

(Dollars in Thousands)	2013	2012	Amount Increase/ (Decrease)	% Change Increase/ (Decrease)
Cash and Short Term Investments	\$ 2,145	\$ 2,355	\$ (210)	(8.92)%
Receivables	327	283	44	15.55%
Investments, at Fair Value	381,063	340,498	40,565	11.91%
Total Assets	\$ 383,535	\$ 343,136	\$ 40,399	11.77%
Accounts Payable	\$ 114	142	(28)	(19.72)%
Accrued Expenses	224	257	(33)	(12.84)%
Total Liabilities	\$ 338	\$ 399	\$ (61)	(15.29)%
Net Assets Held in Trust for Benefits	\$ 383,197	\$ 342,737	\$ 40,460	11.80%

**Table #2: CHANGES IN MCERA NET ASSETS
As of June 30, 2013 and 2012**

(Dollars in Thousands)	2013	2012	Amount Increase (Decrease)	% Change Increase/ (Decrease)
Additions				
Employer Contributions	\$ 14,260	\$ 11,811	\$ 2,449	20.73%
Member Contributions	4,713	4,840	(127)	(2.63)%
Net Investment Income	48,890	(4,079)	52,969	1298.74%
Total Additions	\$ 67,863	\$ 12,573	\$ 5,290	439.76%
Deductions				
Retirement Benefits ⁽¹⁾	\$ 25,501	\$ 22,955	\$ 2,546	11.09%
Refund of Contributions	1,072	1,225	(153)	(12.49)%
Administrative Expenses	830	698	132	18.83%
Total Deductions	\$ 27,403	\$ 24,879	\$ 2,524	10.15%
Net Increase/Decrease	\$ 40,460	\$ (12,306)	\$ 52,766	418.59%
Net Assets at Beginning of Year	\$ 342,737	\$ 355,043	\$ (12,306)	(3.47)%
Net Assets at End of Year	\$ 383,197	\$ 342,737	\$ 40,460	11.80%

(1) Retirement benefits include transfers to Human Resources for retiree health care costs.

ADDITIONS TO PLAN ASSETS

The primary sources to finance the benefits MCERA provides to its members are accumulated through income on investments and through the collection of employee and employer contributions. These income sources for the fiscal year ended June 30, 2013 totaled \$ 67.9 million and June 30, 2012 totaled \$12.6 million. The increase in revenues from 2012 to 2013 can be attributed primarily to gains in the net appreciation in the fair value of investments. The total balance of net assets increased from approximately \$343 million in 2012 to \$383 million in 2013.

DEDUCTIONS IN PLAN ASSETS

The primary uses of MCERA assets are the payment of benefits to retirees and their beneficiaries, refunds of contributions to terminated employees, and the cost of administering the system. These expenses for the fiscal years ended June 30, 2013 and June 30, 2012 were \$27.4 million and \$24.9 million respectively. The primary reason for this change was an increase in benefits paid to retirees.

MCERA FINANCIAL RESERVES

**Table #3: MCERA RESERVES
As of June 30, 2013 and 2012**

(Dollars in Thousands)	2013	2012
Member Reserve	\$ 57,320	\$ 62,998
Employer Reserve	(48,388)	(35,311)
Annuitant Reserve	199,542	180,571
Cost of Living Reserve	93,694	90,402
Undesignated Reserve ⁽¹⁾	659	659
Contingency Reserve	3,835	3,551
Miscellaneous Reserves	200	257
Total Reserves	\$ 306,862	\$ 303,127

MCERA’s reserves are established from contributions and the accumulation of investment income after satisfying investment and administrative expenses. Under GASB 25, investments are stated at fair value instead of cost and include the recognition of unrealized gains and losses in the current period. MCERA has adopted a five-year smoothing methodology for investment gains and losses. This has the effect of smoothing both positive and negative fluctuations in investment performance versus assumptions and has a stabilizing effect on contribution rates.

⁽¹⁾ The undesignated reserve used historically for health care benefits of retirees was derived from excess earnings of the Association in prior years. The disposition of this reserve is still under review by MCERA’s legal, actuarial, and fiscal advisors. It is still reflected in the actuarial report as “Retiree Health Insurance Reserve.”

Major Initiatives and Significant Events

Several major initiatives were undertaken during the year including:

- The Board of Retirement engaged in a strategic planning session which led to the adoption of a mission statement, core values, goals and objectives for MCERA.
- Implemented the initiatives included in the pension reform legislation.
- Selected a service provider to install a pension administration system.
- Enhanced Board governance with the adoption of various charter and policies.
- Adopted significant revisions to the disability application procedures.
- Adopted changes to the actuarial funding policy.
- Implemented the initiatives included in the pension reform legislation known as PEPRA (California Public Employees' Pension Reform Act of 2013).

Accounting Systems and Reports

MCERA management is responsible for establishing a system of internal control to safeguard assets and for the presentation of the accompanying basic financial statements. Oversight is provided by MCERA Audit and Budget Committee. Gallina LLP audited the accompanying basic financial statements and related disclosures.

The CAFR was prepared in accordance with GAAP and reporting guidelines set forth by the Governmental Accounting Standards Board (GASB) and the County Employees Retirement Law of 1937. GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of management discussion and analysis (MD&A).

This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. MCERA's MD&A can be found immediately following the independent auditor's report.

Investment and Economic Summary

In accordance with state constitutional mandates, the Board adopts a strategic asset allocation policy designed to ensure diversification among asset classes and achieve MCERA's long-term investment objectives. Although MCERA invests on a long term horizon, short term returns are important to keep in mind.

The investment return for the year ending June 30, 2013 was 14.52% which was ahead of the benchmark by 2.23%. The returns were 11.36%, 5.71% and 5.95% for three, five and seven year periods ending June 30, 2013, respectively.

The Association maintains an assumed rate of investment return of 7.75% per year. The rate of return on MCERA's investment portfolio is an integral component of the annual additions to the pension plan as total investment income is typically the largest contributor to the Plan's annual additions to retirement plan assets.

Funded Status and Actuarial Reporting

MCERA maintains a funding goal to establish contributions that fully fund the System's liabilities, and that, as a percentage of payroll, remain as level as possible for each generation of active members. Actuarial valuations are performed annually with actuarial experience investigations conducted triennially in accordance with state statute. The use of realistic assumptions is important in maintaining the necessary funding while paying promised benefits. Each year the actual experience of the System is compared to our assumptions and the differences are studied to determine whether changes in the contribution requirements are necessary. In addition, triennially, the actuarial experience investigation is undertaken to review the actuarial assumptions and compare the actual experience during the preceding three year period with that expected under those assumptions.

In December 1996, the County issued its Taxable Pension Obligation Bonds (POBs) in the aggregate principal amount of \$30,720,000. In December 2002, the County issued its Taxable Pension Obligation Bonds, Refunding Series 2002 in the aggregate principal amount of \$91,945,000 to defease a portion of the 1996 POBs and to provide funds to allow the County to refund its then current unfunded actuarial accrued liability for retirement benefits for County employees. The County has contributed to the Association an aggregate amount of \$106,411,000 from the issuance of the 1996 POBs and the 2002 POBs to reduce the UAAL. As of June 30, 2013, the 2002 POBs are outstanding in the principal amount of \$76,000,000 with annual payment requirements of approximately \$8,000,000 due in July of each year until July 2026.

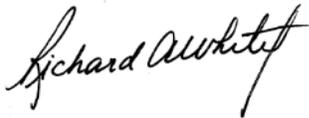
In the June 30, 2013 valuation, the ratio of actuarial value of assets to the actuarial value of liabilities was 74.2% which was an increase from the prior year's valuation funded ratio of 74.1%. The Association's unfunded actuarial liability (UAAL) as of June 30, 2013 was \$131,684,255. As of June 30, 2013, there are 26 years remaining in the declining 30-year amortization period of the UAAL.

The aggregate employer rate calculated in this valuation increased to 26.28% of payroll from 25.65% in last year's valuation. The aggregate employee rate decreased to 9.62% of payroll from 9.76% in last year's valuation. The aggregate rate as of June 30, 2012 was recalculated for the current year actuarial valuation report which indicated that the aggregate employer rate was 25.48% and the aggregate employee rate was 9.60%. Thus, using the recalculated figures, the aggregate employer rate in this valuation increased to 26.28% of payroll from 25.48% in last year's valuation and the aggregate employee rate increased to 9.62% of payroll from 9.60% in last year's valuation.

Request for Information

The financial report is designed to provide the MCERA Board of Retirement, our membership, taxpayers, investment managers and creditors with a general overview of MCERA finances and to account for the money it receives. Questions concerning any of the information in this report or requests for additional financial information should be addressed to Mendocino County Employees' Retirement Association, 625-B Kings Court, Ukiah, California 95482

Respectfully submitted,

A handwritten signature in black ink that reads "Richard A. White, Jr." in a cursive style.

Richard A. White, Jr.
Retirement Administrator

STATEMENT OF PLAN NET POSITION
As of June 30, 2013 and 2012

ASSETS	<u>2013</u>	<u>2012</u>
<u>Investments, at fair value:</u>		
Mutual Funds	\$ 304,575,349	\$ 276,504,957
Public equity securities	42,628,539	33,517,464
Real estate partnerships	32,994,779	29,736,494
Cash equivalents	2,144,879	2,354,860
Real estate – 625 Kings Court, Ukiah, Ca	864,000	738,992
Total Investments, at fair value	<u>383,207,546</u>	<u>342,852,767</u>
<u>Receivables:</u>		
Member contributions receivable	81,192	75,196
Employer contributions receivable	<u>233,170</u>	<u>204,466</u>
Total Receivables	314,362	279,662
<u>Other assets</u>	<u>13,162</u>	<u>3,786</u>
TOTAL ASSETS	\$ <u>383,535,070</u>	\$ <u>343,136,215</u>
 LIABILITIES		
<u>Liabilities:</u>		
Accounts payable	114,416	142,052
Accrued expenses and other liabilities	<u>223,837</u>	<u>257,351</u>
TOTAL LIABILITIES	\$ <u>338,253</u>	\$ <u>399,403</u>
Net Position	\$ <u>383,196,817</u>	\$ <u>342,736,812</u>

The accompanying notes to the financial statements are an integral part of this statement.

STATEMENT OF CHANGES IN PLAN NET POSITION
For The Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<u>Additions to net assets attributed to:</u>		
<u>Investment income (loss):</u>		
Net realized and unrealized appreciation (depreciation) in fair value of investments	\$ 41,174,278	\$ (11,133,208)
Rent income, net of expenses	76,752	45,644
Interest income	23,223	64,384
Dividend income	8,248,645	7,260,965
Investment expenses	<u>(632,406)</u>	<u>(316,274)</u>
Total investment income (loss), net	48,890,492	(4,078,489)
<u>Contributions:</u>		
Member contributions	\$ 4,712,593	\$ 4,840,275
Employer contributions	<u>14,260,473</u>	<u>11,811,076</u>
Total contributions	<u>18,973,066</u>	<u>16,651,351</u>
Total additions, net	\$ 67,863,558	\$ 12,572,862
<u>Deductions from net assets attributed to:</u>		
Benefits paid to retirees	26,573,554	24,180,110
Administrative expenses	<u>829,999</u>	<u>698,463</u>
Total deductions	\$ 27,403,553	\$ 24,878,573
Net increase (decrease) in net position	40,460,005	(12,305,711)
Net Position		
Balance at Beginning of Year	\$ 342,736,812	\$ 355,042,523
Balance at End of Year	\$ 383,196,817	\$ 342,736,812

The accompanying notes to the financial statements are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS

For the Years ended June 30, 2013 and 2012

Note 1: Description of Plan:

Description of Association and Applicable Provisions of the Law:

The Mendocino County Employees' Retirement Association (MCERA or the Plan) is an integrated public retirement system established under and subject to the legislative authority of the State of California as enacted and amended by the County Retirement Act of 1937 (Chapter 677 Statutes of 1937). MCERA is a multiple-employer cost sharing defined benefit plan for the County of Mendocino, the Mendocino County Courts, and the Russian River Cemetery District. MCERA was approved by the Board of Supervisors to become effective January 1, 1948, and was integrated with Social Security on January 1, 1956.

Membership in the Plan at June 30, 2013 consisted of the following:

Retirees and beneficiaries receiving benefits	1,287
Terminated plan members entitled to but not yet receiving benefits	345
Active plan members	1,072
 Total	 2,704
Number of participating employers	3

A cost-sharing multiple employer plan is a single plan with pooling (cost-sharing) arrangements for the participating employers. All risks, rewards, and costs, including benefit costs, are shared and are not attributed individually to the employers. A single actuarial valuation covers all plan members. Other special districts within Mendocino County are eligible, but have not elected to participate.

All permanent employees who work at least 32 hours per week become members of the Plan on the first day of the pay period following employment. Employees are classified as either General or Safety (Law Enforcement or Probation) members, and are assigned to one of five tiers based on entry date and job classification.

Retirement benefits offered by the Plan include normal retirement, disability retirement and service-connected disability retirement. A death benefit is available to beneficiaries. An annual cost of living adjustment of no more than 3 percent may be granted by the Board of Retirement.

Note 1: Description of Plan, continued:

Description of Association and Applicable Provisions of the Law, continued:

The Cost of Living Adjustment may be increased up to the maximum of three percent (3%) by applying accumulated adjustments carried forward from those years where the increase in the reported cost of living exceeded three percent. Effective April 1, 2013, for benefit recipients who began receiving benefits on or before April 1, 1985, their allowances will be increased by a 3.0% COLA, with 1.0% deducted from their COLA banks. For benefit recipients who began receiving benefits on April 2, 1985 through April 1, 2013, their allowances will be increased by 2.0% with no reduction in their COLA banks, since their COLA banks are presently at zero.

Health benefits for retired employees have been funded by the Plan in the past. Reimbursements of retiree medical costs paid by the County of Mendocino were made in the past from a MCERA account established with "excess earnings" as allowed under the CERL and intended to represent a retiree medical account under section 401(h) of the Internal Revenue Code. There were no amounts paid from the retiree medical account during the year ended June 30, 2013. MCERA filed an application with the Internal Revenue Service (IRS) in January 2011 for a determination letter as to the tax qualified status of the system and also filed under the IRS voluntary correction program (VCP) procedure. The IRS is reviewing these applications and under its normal process will respond to MCERA regarding its filings. Any issues regarding compliance of the retiree medical account with Internal Revenue Code section 401(h) are included in the IRS review and will be addressed as part of that process.

Note 2: Summary of Significant Accounting Policies

Reporting Entity:

MCERA is governed by the Board of Retirement and is considered an independent entity. The Association is a component unit of the County of Mendocino and is being reported as a Pension Trust Fund in the County's Financial Report in accordance with Governmental Accounting Standards Board Statement No. 14.

Basis of Accounting:

The Association follows Governmental Accounting Standards Board (GASB) accounting principles and reporting guidelines, and financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the Plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

Note 2: Summary of Significant Accounting Policies, continued

Use of Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Retirement Administrator to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

Derivatives:

MCERA's investment policy permits the use of derivative instruments to minimize the exposure of certain of its investments to adverse fluctuations in financial and currency markets and enhance yields. MCERA does not use derivatives for speculative use or to create leverage.

During the year ended June 30, 2013 MCERA owned no derivatives directly in its portfolio.

Custodial Credit Risk:

Custodial risk for deposits in the Mendocino County trust is assumed by the County of Mendocino. Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, MCERA would not be able to recover the value of the investment or collateral securities that are in possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in MCERA's name, and held by the counterparty. MCERA's investment securities are not exposed to custodial credit risk because all securities are held directly with various investment companies in MCERA's name.

Except for a statement that duties of the Board of Retirement, MCERA officers and employees shall be discharged with care, skill, prudence, and diligence, MCERA has no formal policy for managing custodial credit risk.

Market and Credit Risk:

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of net assets available for benefits and the statement of changes in net assets available for benefits.

Note 2: Summary of Significant Accounting Policies, continued

Market and Credit Risk continued:

Credit risk is the risk that an issuer or other counterparty to a debt instrument will not fulfill its obligations. This is measured by the assignment of ratings by nationally recognized statistical rating organizations. Investment allocation guidelines according to the investment policy are as follows:

	<u>Allowable Range</u>	<u>Current Allocation</u>
U.S Equity	33% - 43%	41%
Non-U.S. Equity	20% - 30%	26%
U.S. Fixed Income	23% - 33%	24%
Real Estate	4% - 14%	9%

MCERA's Investment Policy does not allow for a single investment in real estate that is in excess of 5% of total assets. With respect to common stocks, MCERA has a goal of diversifying the portfolio among a cross-section of industries that have sound long-term growth potential. Similar restrictions apply to fixed income securities.

Interest Rate Risk:

Interest rate risk is the risk that changes in the interest rate will adversely affect the fair value of an investment. MCERA has not adopted a formal policy to manage interest rate risk.

Member Termination:

Upon separation from MCERA, members' accumulated contributions are refundable with interest accrued through the prior June 30 or December 31. Interest on member accounts is credited semiannually on June 30 and December 31. Withdrawal of such accumulated contributions results in forfeiture of the related vested benefits.

Plan Termination:

MCERA is administered in accordance with the provisions of California Government Code Section 31450 and accompanying code sections. California Government Code Section 31483 allows the governing body of the County, the County Courts, or special district, through the adoption of an ordinance or resolution, to terminate the applicability of the Plan to employees of the County, Courts, or district whose services commence after a given future date.

Note 2: Summary of Significant Accounting Policies, continued:

Risk Management:

MCERA is exposed to various risks of losses related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; natural disasters; and major downturns in financial markets. For the past several years, MCERA has obtained coverage from commercial insurance companies for errors and omissions coverage related to activities of the Board of Retirement, but all other risks of loss, except losses due to depreciation in the fair market value of investments, is assumed by the sponsoring employers. MCERA has effectively managed risk through various employee education and prevention programs and careful selection of investments. Expenditures and claims are recognized when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

The Mendocino County Department of Human Resources has assumed the duties of administering the health care claims of retirees. As described in Note 2, MCERA filed an application with the IRS in January 2011 for a determination letter as to the tax qualified status of the system and also filed under the IRS VCP procedure. If in preparing for a determination letter application filing with the IRS, the retirement system determines that there are issues about the tax rules as applied to the system, the IRS also encourages the system to file an application under its VCP procedure. The IRS is reviewing MCERA's determination letter and VCP applications and under its normal process will respond to MCERA regarding its filings. Any issues regarding compliance of MCERA with the Internal Revenue Code, including compliance of the retiree medical account with Code section 401(h), are included in the IRS review and will be addressed as part of that process.

Based on Mendocino County Board of Supervisors Resolution No. 98-147, County Counsel concluded that the County Board of Supervisors was ultimately responsible for dealing with any retiree health benefits that might be provided to retired employees of the County. MCERA therefore had no incurred but not reported claims as liabilities showing on the financial statements for the year ended June 30, 2013. For the year ended June 30, 2013, MCERA had no "excess earnings" as defined under the CERL that could be used for the payment or reimbursement of retiree health benefits under a Code section 410(h) account.

Administrative Expenses:

The Board of Retirement's policy is that administrative expenses incurred in any year will not exceed twenty-one hundredths of one percent (0.21%) of MCERA's actuarial accrued liability, unless authorized by a separate vote of the Board of Retirement.

Note 2: Summary of Significant Accounting Policies, continued:

Administrative Expenses, continued:

The Board of Retirement approves MCERA's annual budget. The County Employees Retirement Law (CERL) limits MCERA's annual administrative expenses, excluding the costs of administration for computer software and hardware and computer technology consulting services (IT costs), to twenty-one hundredths of one percent (0.21%) of MCERA's actuarial accrued liability or \$2 million, whichever is greater.

MCERA's actual administrative expense was \$829,999 which represented 0.17% of MCERA's actuarial accrued liability or 41.5% of the \$2 million statutory cap.

Schedule of Funding Progress:

The supplemental Schedule of Funding Progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liability for benefits over time.

Current and Future Accounting Pronouncements:

GASB Statement No. 53 - Accounting and Reporting for Derivative Instruments became effective for all years beginning after June 15, 2009. This statement provides a comprehensive framework for the measurement, recognition, and disclosure of derivative instrument transactions. If MCERA invests in derivative instruments in the future, this statement will be used to measure, recognize, and disclose those transactions.

GASB Statement No. 61 - The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and No. 34, modifies certain requirements for inclusion of component units in the financial reporting entity, and amends the criteria for reporting component units as if they were part of the primary government. Although the provisions for this statement are effective for fiscal years beginning after June 15, 2012, it seems to clarify and confirm the existing relationship of MCERA as a component unit of the County of Mendocino.

GASB Statement No. 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for periods beginning after December 15, 2011, will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source.

GASB Statement No. 63 – Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, effective for periods beginning after December 15, 2011. This statement establishes standards of reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and also requires related disclosures.

Note 2: Summary of Significant Accounting Policies, continued:

Current and Future Accounting Pronouncements, continued:

GASB Statement No. 65 – Items Previously Reported as Assets and Liabilities, effective for periods beginning after December 15, 2012. This statement specifies the items that were previously reported as assets and liabilities that should now be reported as deferred outflows of resources, deferred inflows of resources, outflows of resources, or inflows of resources.

Subsequent Events:

Management has evaluated all subsequent events through March 11, 2014, the date the financial statements were available to be issued. See Note 7 for additional information.

Note 3: Investments:

Investments are reported at fair value. Investments that do not have an established market are reported at estimated fair value. All investments listed in the Statement of Net Assets Available for Benefits, except for real estate and cash equivalents, are registered securities held by the Association's agent in the Association's name. The Board of Retirement has exclusive control over all investments of the Association and is responsible for establishing investment objectives, strategies and policies.

The Board of Retirement has adopted an Investment Policy, which provides the framework for the management of MCERA's investments. The Investment Policy establishes MCERA's investment objectives and defines the principal duties of the Board of Retirement and the investment managers. The asset allocation plan is an integral part of the Investment Policy and is designed to provide an optimum and diversified mix of asset classes with return expectations to satisfy expected liabilities while minimizing risk exposure. MCERA currently employs investment managers to manage its assets subject to the provisions of the investment Policy.

Cash equivalents consist of cash in trust with the Treasurer of the County of Mendocino. Cash from deposits and cash needed for daily operational purposes is held in a pooled account with other County funds. The County Treasurer is responsible for the management, control and safekeeping of all investments in the pooled fund. Interest on funds in the County investment pool is computed quarterly based on average daily balance. A deposit in the pooled account approximates fair value.

Security transactions are accounted for on a trade date basis. Interest income is recognized when earned and dividend income is recognized on the ex-dividend date. Stock dividends or stock splits are recorded as memo items and do not affect the total value of the securities. Unrealized gains and losses on investments are reported as "net appreciation (depreciation) in the fair value of investments." The calculation of realized gains and losses is independent of the calculation of net appreciation (depreciation) in the fair value of Plan investments.

Note 3: Investments, continued:

The Association's cash and investments stated at fair value as of June 30, 2013 and 2012 are as follows:

	2013	2012
Cash in trust - Mendocino County	\$ 2,144,879	\$ 2,354,860
Total cash equivalents	<u>2,144,879</u>	<u>2,354,860</u>
U.S. Government and corporate bonds	93,171,941	92,893,393
International equities	79,092,535	62,850,363
Domestic equities – small cap	25,054,335	17,224,358
Domestic equities – mid cap	19,618,107	21,744,297
Domestic equities – large cap	87,638,431	81,792,546
Total mutual funds	<u>304,575,349</u>	<u>276,504,957</u>
Public equity securities	42,628,539	33,517,464
Real estate partnerships	32,994,779	29,736,494
Real estate – 625 Kings Court, Ukiah, CA	<u>864,000</u>	<u>738,992</u>
Total Cash Equivalents and Investments	<u>\$ 383,207,546</u>	<u>\$ 342,852,767</u>

Note 4: Fair Value Measurement of Investments:

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described below:

Level 1:

Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2:

Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Note 4: Fair Value Measurement of Investments, continued:

Level 2 continued:

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3:

Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for investments measured at fair value. There have been no changes in the methodologies used at June 30, 2012.

Mutual funds and real estate partnership: Valued at the net asset value of shares held by the Plan at year end.

Real estate – 625 Kings Court, Ukiah, CA: Valued at the approximate appraised fair value.

The methods described above may produce a fair value calculation that may not be as indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Note 4: Fair Value Measurement of Investments, continued:

The following tables set forth by level, within the fair value hierarchy, MCERA's investments at fair value as of June 30, 2013 and 2012:

	Investments at Fair Value as of June 30, 2013			
	Level 1	Level 2	Level 3	Total
Mutual funds:				
Bond funds	\$ 93,171,941	\$ -	\$ -	\$ 93,171,941
International securities	79,092,535	-	-	79,092,535
Domestic securities	132,310,873	-	-	132,310,873
Total mutual funds	304,575,349	-	-	304,575,349
Public equity securities	42,628,539	-	-	42,628,539
Real estate partnerships	32,994,779	-	-	32,994,779
Real estate - 625 Kings Court, Ukiah, CA	-	-	864,000	864,000
Total investments at fair value	\$ 380,198,667	\$ -	\$ 864,000	\$ 381,062,667

	Investments at Fair Value as of June 30, 2012			
	Level 1	Level 2	Level 3	Total
Mutual funds:				
Bond funds	\$ 92,893,393	\$ -	\$ -	\$ 92,893,393
International securities	77,140,774	-	-	77,140,774
Domestic securities	139,988,255	-	-	139,988,255
Real estate	23,374,029	-	-	23,374,029
Total mutual funds	333,396,451	-	-	333,396,451
Real estate partnership	6,362,464	-	-	6,362,464
Real estate - 625 Kings Court, Ukiah, CA	-	-	738,992	738,992
Total investments at fair value	\$ 339,758,915	\$ -	\$ 738,992	\$ 340,497,907

Note 4: Fair Value Measurement of Investments, continued:

The following table sets forth a summary of changes in the fair value of the Plan's Level 3 investments for the year ending June 30, 2013 and 2012 as follows:

Commercial Building at 625 Kings Court, Ukiah California

	<u>2013</u>	<u>2012</u>
Fair value, beginning of year	\$ 738,992	\$ 738,992
Unrealized gain (loss)	125,008	-
Purchases	-	-
Sales	-	-
Issuances	-	-
Settlements	-	-
Fair value, end of year	<u>\$ 864,000</u>	<u>\$ 738,992</u>

Note 5: Contributions:

The actuarially determined member contribution rates payable for fiscal year 2014-15 averaged 9.62 percent of payroll and 9.76 percent of payroll for the year ended June 30, 2012. The actual member rate depends on the member's age at the time of hire, General, Safety, or Probation membership, and tier. For fiscal year 2014-15, employers are also required to contribute an actuarially determined rate of 26.28 percent of payroll in aggregate. The employer aggregate rate was 25.65 percent of payroll for the year ended June 30, 2012. The actual employer rate depends on General, Safety, or Probation membership, and tier. The member and employer contribution rates are adjusted annually to maintain the appropriate funding status of the Plan. The employer contribution rate is actuarially determined to provide for the balance of the contributions needed to fund the annual normal cost (basic and cost of living) and the amortization of the unfunded actuarial accrued liability.

The Plan had an unfunded actuarial accrued liability of \$47,154,000 at June 30, 2001. This unfunded liability was being amortized through June 30, 2017, at which time it was anticipated the Plan would be fully funded. In December, 1996, the County of Mendocino issued pension obligation bonds, of which \$30,112,488 of the proceeds were contributed to the Plan. In December, 2002, due to a continued downward spiral of market values for MCERA investments, the County of Mendocino issued additional pension obligation bonds. The total of bonds sold was \$92,208,602, of which \$76,299,000 was transferred to the Plan for additional investment, \$13,220,061 was used to defease fifty percent of the 1996 pension obligation bonds, and the remainder of \$2,689,541 was used to pay the costs of issuing the bonds. The proceeds from the 2002 pension obligation bonds reduced the unfunded pension liability to less than 10 percent of the actuarial accrued liability at June 30, 2004. The funding agreement in effect prior to July 1, 2009 indicated that the County was not required to fund the UAAL that was not in excess of the target of 10 percent of the total pension liability. In November 2009, that funding agreement was voided by mutual agreement between the Association Board of Retirement and the

Note 5: Contributions, continued:

Mendocino County Board of Supervisors. Subsequent to the funding agreement, the Board of Retirement stipulated that the Plan Sponsors must amortize the UAAL over a 30-year period from June, 2009.

The UAAL as of June 30, 2013 is \$131.7 million, which the Plan Sponsors are required to amortize in the future. The funded ration at June 30, 2013 is 74.2%, as indicated on the Schedule of Funding Progress on Page 37. The Actuarial Valuation and Review report issued by The Segal Company as of June 30, 2013 recommended employer and member contribution rates that aggregate to 26.28% and 9.62%, respectively.

Note 5: Contributions, continued:

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	June 30, 2013
Actuarial cost method	Entry age cost method (individual basis)
Amortization method	Level % of payroll for total unfunded liability
Remaining amortization period	26 years (declining/closed) for all UAAL
Asset valuation method	Market value of assets less unrecognized returns in each of the last five years. Unrecognized return is equal to the difference between the actual market return and the expected return on the market value, and is recognized over a five year period, further adjusted, if necessary, to be within 25% of the market value. The valuation value of assets is the actuarial value of assets reduced by the value of the non-valuation reserves.
Actuarial assumptions:	
Investment rate of return	7.75%
Inflation rate	3.50%
Real across-the-board salary increase	0.50%
Projected salary increases *	4.50% to 9.00%
* Includes inflation at	3.50% plus real across-the-board salary increase of 0.50% plus merit and longevity increases
Cost of living adjustments	3.00% of retirement income
Years of life expectancy after retirement	General members: RP-2000 Combined Healthy Mortality Table for males and females, set back 2 years for males and 1 year for females Safety/Probation members: RP-2000 Combined Healthy Mortality Table for males and females, with no setback for males and 1 year set forward for females.
Years of life expectancy after disability	General members: RP-2000 Combined Healthy Mortality Table for males and females, set forward 2 years. Safety/Probation members: RP-2000 Combined Healthy Mortality Table for males and females, set forward 4 years.

Note 5: Contributions, continued:

Life expectancy after retirement for employee contribution rate purposes	General members: RP-2000 Combined Healthy Mortality Table for males and females, set back 2 years for males and 1 year for females weighted 30% male and 70% female. Safety/Probation members: RP-2000 Combined Healthy Mortality Table for males and females, with no setback for males and 1 year set forward for females weighted 80% male and 20% female.
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Using the projected payroll amounts for MCERA's membership groups and tiers that were used in the June 30, 2011 actuarial valuation, management has estimated the contributions are comprised of the following for the year ended June 30, 2013:

Estimated employer normal cost	\$ 7,403,034
Estimated UAAL contributions	6,857,439
	\$ 14,260,473

Note 6: Reserves:

The Association had contingency reserves of \$3,835,531 and \$3,550,728 at June 30, 2013 and 2012, respectively to fund transfers to retirement reserve accounts in the event that sufficient earnings on investments are not received in the future to fulfill the requirement of transferring current earnings to the extent of 7.75 percent of retirement reserve balances to those reserves.

Note 6: Reserves, continued:

Member and employer contributions are allocated to various legally required reserve accounts based on actuarial determinations. A summary of the various reserve accounts, which comprise net assets available for pension and other benefits at June 30, 2013 and 2012 (under the five-year smoothed asset valuation method for actuarial valuation purposes), is as follows:

	<u>2013</u>	<u>2012</u>
Employee reserves	\$ 57,319,952	\$ 62,997,613
Employer reserves	(48,388,438)	(35,311,033)
Retiree reserves	293,235,630	270,972,746
Undesignated reserves (see Note 7)	658,654	658,654
1% Contingency reserve	3,835,531	3,550,728
Settlement reserve	200,106	248,093
Miscellaneous reserves	235	9,259
Total reserves	<u>306,861,670</u>	<u>303,126,060</u>
Cumulative unallocated net unrealized gain on investments	<u>75,750,705</u>	<u>62,792,624</u>
Total allocated reserves (smoothed market actuarial value after corridor limits)	382,612,375	365,918,684
Net assets in excess (deficit of reserves)	<u>584,442</u>	<u>(23,181,872)</u>
Net assets available for pension benefits, at fair value	<u>\$ 383,196,817</u>	<u>\$ 342,736,812</u>

The undesignated reserve used historically for providing health care benefits of retirees was derived from excess earnings of the Association in prior years.

Note 7: Subsequent Events:

Subsequent events are those events or transactions that occur subsequent to the effective date of the financial statements, but prior to the issuance of final reports, which may have a material effect on the financial statements or disclosures therein.

The fair value of assets in MCERA's portfolio has increased from \$383 million to \$405 million between July 1, 2013 and September 30, 2013. Capital markets continue to be highly volatile resulting in significant swings in market value, both positive and negative.

Since July 1, 2011, MCERA's new actuary, The Segal Company (Segal), determined that the employee basic contribution rate for fiscal years 2009-10, 2010-11 and 2011-12, as calculated by the prior actuary, was higher in the aggregate than it should have been. This resulted in a corresponding underpayment by employers during the same period. MCERA is working with a team of external and internal professionals to reimburse overpayments and collect underpayments to the pension fund based on the corrected rates, and in accordance with all tax laws and regulations. Corrected rates will be in effect January 8, 2012, and the project is expected to be completed before the end of fiscal year 2013-14.

Note 7: Subsequent Events continued:

MCERA submitted a Voluntary Correction Program (VCP) filing with the IRS, stating that it recognized and posted excess earnings of \$9.6 million, for fiscal years ending June 30, 2004 through 2006 that may not have been fully consistent with Government Code Section 31529.4 and/or IRC Section 401(h). The residual amount of excess earnings recognized and posted over this time period has been classified as "Undesignated reserves" and was \$658,654 at June 30, 2012. The excess earnings postings are being reviewed by tax counsel, actuary, and an accounting firm to develop findings and recommendations for submission to the IRS. The IRS review on issues common to retirement systems such as MCERA that are maintained under the County Employees' Retirement Law of 1937 has begun. The IRS review, including any issues specific to MCERA, is expected to be completed sometime in calendar year 2014.

Required Supplementary Information

The Schedule of Funding Progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liability for benefits over time.

SCHEDULE OF FUNDING PROGRESS ⁽¹⁾
GASB 25
(Dollar amounts in thousands)

Actuarial		Actuarial	Unfunded			UAAL
Valuation	Valuation	Accrued	AAL	Funded	Covered	as a Percent
Date	Assets	Liability	(UAAL)	Ratio	Payroll	of Covered
		(AAL)				Payroll
7/1/94	\$ 75,976	\$ 112,535	\$ 36,559	67.5%	\$ 27,185	134.5%
7/1/95	\$ 79,322	\$ 121,027	\$ 41,705	65.5%	\$ 29,603	140.9%
7/1/96	\$ 84,992	\$ 130,036	\$ 45,044	65.4%	\$ 29,587	152.2%
7/1/97	\$ 124,286	\$ 140,783	\$ 16,497	88.3%	\$ 32,481	50.8%
7/1/98	\$ 134,836	\$ 154,263	\$ 19,427	87.4%	\$ 35,586	54.6%
7/1/99	\$ 142,775	\$ 173,250	\$ 30,475	82.4%	\$ 39,209	77.7%
7/1/00	\$ 150,056	\$ 185,423	\$ 35,367	80.9%	\$ 44,132	80.1%
7/1/01	\$ 157,545	\$ 204,699	\$ 47,154	77.0%	\$ 53,188	88.7%
7/1/02	\$ 158,115 (2)	\$ 226,883	\$ 68,768	69.7%	\$ 57,701	119.2%
7/1/03	\$ 233,764 (3)	\$ 243,342	\$ 9,578	96.1%	\$ 59,865	16.0%
7/1/04	\$ 239,191	\$ 265,141	\$ 25,950	90.2%	\$ 59,075	43.9%
7/1/05	\$ 253,487	\$ 289,467	\$ 35,980	87.6%	\$ 57,664	62.4%
7/1/06	\$ 288,461	\$ 320,123	\$ 31,662	90.1%	\$ 57,665	54.9%
7/1/07	\$ 317,937	\$ 358,259	\$ 40,322	88.7%	\$ 65,899	61.2%
7/1/08	\$ 353,421	\$ 373,832	\$ 20,411	94.5%	\$ 70,880	28.8%
7/1/09	\$ 336,263	\$ 403,196	\$ 66,933	83.4%	\$ 72,235	92.7%
7/1/10	\$ 343,202	\$ 434,987	\$ 91,785	78.9%	\$ 69,004	133.0%
7/1/11	\$ 347,732	\$ 472,644	\$ 124,912	73.6%	\$ 64,144 (4)	194.7%
7/1/12	\$ 362,487	\$ 489,014	\$ 126,527	74.1%	\$ 56,596	223.6%
7/1/13	\$ 378,777	\$ 510,461	\$ 131,684	74.2%	\$ 56,464	233.2%

(1) Information prior to 2011 has been extracted from the previous actuary's past valuation reports.

(2) Excludes proceeds from Pension Obligation Bonds issued in December 2002.

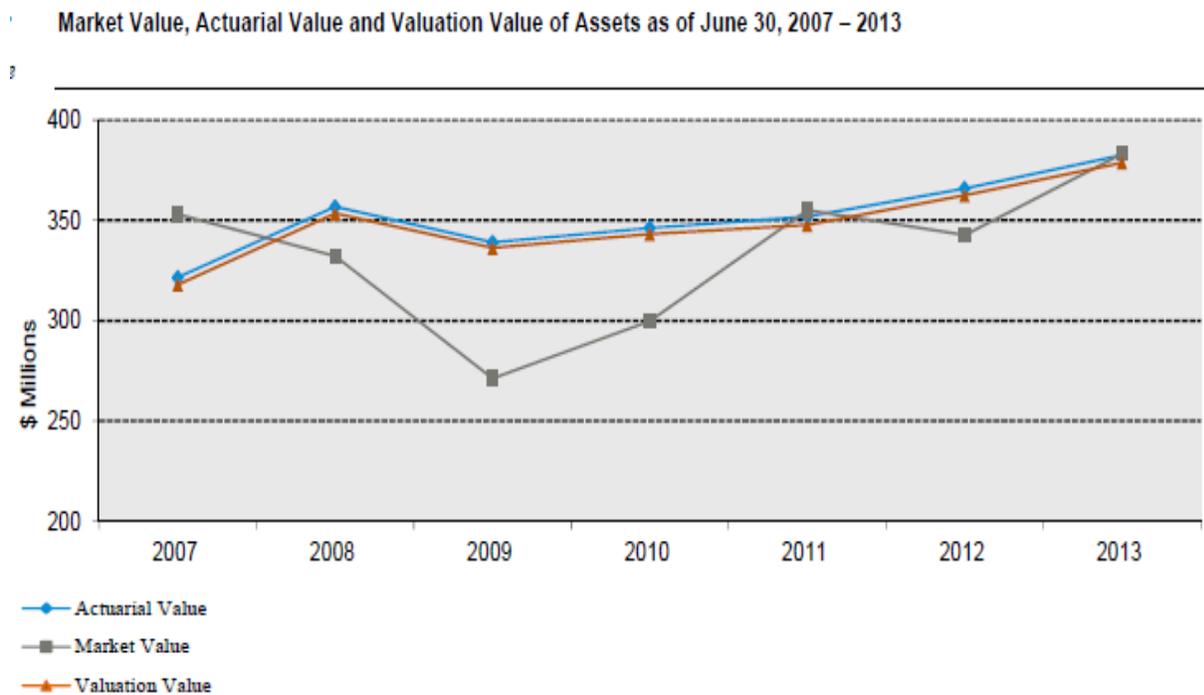
(3) Includes proceeds from Pension Obligation Bonds issued in December 2002 in the amount of 76,299,000.

(4) 6/30/2011 payroll includes a projection for expected salary increases during 2011/2012 under the actuarial assumptions used in valuation.

There is no single all-encompassing indicator which measures a retirement system's funding progress and current funded status. A traditional measure has been the relationship of valuation assets to unfunded actuarial accrued liability as a measure that is influenced by the choice of actuarial cost method. Historical trend information is presented in the following schedules.

This information was determined as part of the actuarial valuations at the dates indicated. Governmental Accounting Standard Board (GASB) requires the Actuarially Required Contributions (ARC) and the Funding Status Schedules to be included and we do so in the following schedules.

The following chart shows the change in market value, actuarial value and the valuation value of assets over the past seven years.



SCHEDULE OF EMPLOYER CONTRIBUTIONS
GASB 25
(dollar amounts in thousands)

Year Ended	Annual Recommended Contribution	Percentage Contributed
12/31/93	\$ 2,939	100%
6/30/95	\$ 5,182	100%
6/30/96	\$ 4,348	100%
6/30/97	\$ 33,691	100%
6/30/98	\$ 2,661	100%
6/30/99	\$ 3,165	100%
6/30/00	\$ 3,787	100%
6/30/01	\$ 7,216	100%
6/30/02	\$ 6,348	100%
6/30/03	\$ 6,663	100%
6/30/04	\$ 4,158	63%
6/30/05	\$ 3,221	47%
6/30/06	\$ 4,996	79%
6/30/07	\$ 7,533	100%
6/30/08	\$ 7,232	100%
6/30/09	\$ 6,046	141%
6/30/10	\$ 9,571	91%
6/30/11	\$ 9,554	100%
6/30/12	\$ 11,811	100%
6/30/13	\$ 14,260	100%

(1) Reflects 18 months of contributions due to a change in the financial reporting year.

(2) Includes proceeds from Pension Obligation Bonds.

SCHEDULE OF ADMINISTRATIVE EXPENSES
For the Year ended June 30, 2013 and 2012

	2013	2012
Personnel Services:		
Salaries and Wages	260,130	250,273
Other Benefits	65,715	65,571
Employee Retirement	88,520	59,935
Total Personnel Services	414,365	375,779
Professional Services:		
Outside Legal Counsel – Disability	12,555	60,897
Disability Hearing Officer/Medical Exams	19,199	70,887
External Audit Fees	27,763	22,935
Automation & Software	42,756	6,262
Total Professional Services	102,273	160,981
Miscellaneous:		
Office Expenses *	28,031	33,712
Insurance General	879	976
Memberships	5,050	4,500
Prof & Spec Services – Other	247,955	99,580
Transportation & Travel	31,446	22,935
Total Miscellaneous	313,361	161,703
Total Administrative Expenses	\$ 829,999	\$ 698,463

* Includes 1/2 of Building Expenses.

Administrative Budget: Government Code § 31580.2 states in part, "...the respective board or boards shall annually adopt a budget covering the entire expense of administration of the retirement system which expense shall be charged against the earnings of the retirement fund. The expense incurred in any year may not exceed the greater of the following: 1) Twenty-one hundredths of 1 percent of the accrued actuarial liability of the retirement system. 2) Two million dollars (\$2,000,000)..." MCERA's administrative expenses met the requirements of this section in Fiscal Year 2012/13 as the expenses were less than the administrative cap at 17/100% of the actuarial accrued liability. In Fiscal Year 2011/12 the expenses were 14/100% of the actuarial accrued liability.

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Investment Section



Mendocino County Employees' Retirement Association Executive Summary Fiscal Year Ended June 30, 2013

General Economic Conditions and Capital Markets Overview

The fiscal year ended June 30, 2013 saw impressive gains within equity markets. Following strong, mid-to-high single digit gains in the first quarter of the fiscal year, global equities largely continued their advance through the second quarter, and then spiked during the opening quarter of the calendar year before finishing the fiscal year with low single-digit returns. For the full fiscal year, broad market asset class returns were largely positive, with slightly negative returns from fixed income and strong double-digit gains from domestic and developed international equities. Foreign equities performed very well in the first half of the fiscal year, outpacing US equity results, but US equities finished on top in the second half of the fiscal year. Emerging market equities were significant laggards among global markets and widely underperformed developed equities; still, the MSCI Emerging Markets Index finished in positive territory, up 3.2% for the year. Meanwhile, fixed income markets were soundly beaten in the last quarter of the period, after posting positive returns in the first half of the year. Overall, the Barclays Aggregate Index shed 0.7% during the year.

Investor focus was largely dominated by domestic policy issues during the year. The fiscal year commenced with the breaking of the LIBOR fixing scandal and the Federal Reserve announcement of "open-ended" bond purchases (popularly dubbed "QE3" or "QE-Infinity"), and culminated with the May 22nd release of Federal Reserve meeting minutes indicating that a "tapering" of bond purchases might begin as soon as July. Uncertainty surrounding the US presidential election and concerns over the "fiscal cliff" also loomed during the year, weighing heavily on the minds of investors. The 2nd quarter of the fiscal year commenced as the US presidential election entered its final weeks in a statistical dead heat and concluded with the fiscal cliff debate still unresolved. The US Senate passed a compromise two hours after midnight on New Year's Day that would ultimately be confirmed by the House of Representatives and signed by the President on January 2nd. News of the agreement sent US equity markets soaring on the first trading day of 2013 and major indices finished up about 3% from the December 31st close. The euphoria was short-lived however, as the agreement was centered on tax policy and only postponed action on the sequestration related to future spending cuts for two months. A resolution of the "fiscal cliff" came during the opening quarter of the calendar year after which US markets climbed steadily until news of a financial crisis in the tiny Mediterranean island state of Cyprus set off shockwaves throughout global capital markets. However, as fears of Cyprus contagion in the broader European Union waned, the US equity market resumed its climb through late May to record highs, when the Federal Reserve's comments regarding the tapering of bond purchases then roiled financial markets, sending equity markets tumbling from their all-time highs as bond yields rose to levels not seen in more than a year.

Investment Section

Inflation, both headline and core measures, remained well in-check and actually trended notably downward at the end of the fiscal year. Headline CPI came in at 1.4% in May while Core CPI (excluding Food and Energy) fell to 1.7%. These measures are well below both the 50-year average of 4.2% and 4.1%, respectively, and are also well below the Fed's targeted 2.5% "sustained rate" level that would potentially trigger an increase in short-term policy rates. The housing recovery is beginning to work its way into the CPI calculation as the housing component increased by 2.2% for the 12 months ending May 2013 and shared the top ranking with medical care, which has been significantly tempered in recent quarters after a long stint as the CPI component experiencing the sharpest price increases.

The following table highlights the various asset class benchmark returns by quarter and for the fiscal year.

Index	Q1	Q2	Q3	Q4	Fiscal Year
US Equity (Russell 3000)	6.2%	0.2%	11.1%	2.7%	21.5%
Intl Equity (MSCI ACWI ex-US)	7.5%	5.9%	3.3%	(2.9%)	14.1%
Real Estate (NFI-ODCE)	2.6%	2.1%	2.3%	3.4%	10.8%
Fixed Income (BC Aggregate)	1.6%	0.2%	(0.1%)	(2.1%)	(0.7%)

Asset Allocation

As of June 30, 2013, the assets of MCERA were valued at \$383.5 million, up from the total asset value at the start of the fiscal year, July 1, 2012, of \$343.9 million. Approximately \$49.2 million in investment gains and \$9.5 million in net withdrawals accounted for the rise in assets. The Fund ended the year slightly overweight in domestic equity relative to its policy target while being slightly underweight to fixed income. The Fund's domestic real estate and international equity allocations were nearly in line with those of the policy target. All asset classes remain within their permitted ranges.

Asset Class	\$000s Actual	Percent Actual	Percent Target	Percent Difference	\$000s Difference
Domestic Equity	156,733	40.9%	38.0%	2.9%	10,995
International Equity	97,299	25.4%	25.0%	0.4%	1,419
Domestic Fixed Income	93,172	24.3%	28.0%	(3.7%)	(14,214)
Domestic Real Estate	33,859	8.8%	9.0%	(0.2%)	(658)
Cash	2,459	0.6%	0.0%	0.6%	2,459
Total	383,522	100.0%	100.0%		

Total Fund Performance

MCERA's Total Fund advanced 14.5% for the fiscal year ending June 30, 2013, 2.2% ahead of the Fund's benchmark return.

As is shown in the fiscal year attribution below, active management benefitted relative performance during the period, while the effect of asset allocation was largely neutral. Aggregate performances of the underlying managers in each broad asset class contributed to the Total Fund's outperformance for the year; the Domestic Equity, Domestic Fixed Income and International Equity composites each added between 69 and 84 basis points to the MCERA Total Fund return for the year. Each asset class composite's return ranked well versus peers as well. Overall, the Total Fund's return of 14.5% landed 15th among Public Fund Sponsor peers. Longer term annualized results also rank favorably versus peers, finishing 31st, 16th and 7th for the trailing 5-, 7- and 9-year periods, respectively.

Investment Section

One Year Relative Attribution Effects

Asset Class	Effective Actual Weight	Effective Target Weight	Actual Return	Target Return	Manager Effect	Asset Allocation	Total Relative Return
Domestic Equity	39%	38%	23.76%	21.46%	0.84%	0.07%	0.91%
Domestic Fixed Income	27%	28%	1.66%	(0.69%)	0.70%	0.19%	0.89%
Domestic Real Estate	9%	9%	10.71%	10.56%	0.02%	(0.00%)	0.01%
International Equity	24%	25%	16.87%	14.14%	0.69%	(0.20%)	0.49%
Cash	1%	0%	0.00%	0.00%	0.00%	(0.09%)	(0.09%)
Total			14.52%	= 12.29%	+ 2.26%	+ (0.03%)	2.23%

Summary

The MCERA portfolio benefitted from the upswing of the broad equity markets experienced during the fiscal year. The portfolio cleanly outpaced its target benchmark during the year; driven by positive manager effects across all broad asset class composites, this performance reflects favorable manager selection and adherence to the strategic policy target asset allocation. The Fund remains well diversified across the broad capital markets and across many different investment strategies, which we believe will continue to lead to strong long-term investment results.

At the end of the fiscal year, comments from the May meeting of the Federal Reserve indicated that the Board of Governors may begin to consider a tapering of the current bond purchase program; as a result fixed income suffered dramatically from a sharp rise in interest rates. However, the current volatility in fixed income markets is neither unprecedented nor unexpected and should not cause disciplined investors to make rash decisions. For investors with long term horizons, higher interest rates translate into higher fixed income returns in spite of the immediate short-term capital losses. We continue to forecast muted returns and increased volatility across asset classes. Due diligence reviews and an adherence to a well-developed investment policies remain the most prudent long-term course for investors.

Submitted by:

Greg T. Ungerman, CFA
Senior Vice President

Greg F. DeForrest, CFA
Senior Vice President

Claire Telleen
Assistant Vice President

Outline of Investment Policies

The Board of Retirement (Board) has exclusive control of all investments of the retirement system and is responsible for establishing investment objectives, strategies and policies.

Pursuant to the California Constitution and the 1937 County Employees' Retirement Act, the Board is authorized to invest in any form or type of investment deemed prudent in the informed judgment of the Board. In making decisions regarding the MCERA investment portfolio, the Board acts in a fiduciary capacity and must discharge its duties in accordance with fiduciary principles. In this regard, investment decisions are to be made in the sole interest and for the exclusive purpose of providing benefits to participants in the retirement system and their beneficiaries and defraying the reasonable expenses of administering the retirement system.

The Board of Retirement has adopted an Investment Policy, which provides the framework for the management of MCERA's investments. The Investment Policy establishes the general goals of the investment program, the policies and procedures for management of the investments, specific assets allocations, rebalancing procedures and investment guidelines, performance objectives and risk controls. The Investment Policy also defines the principal duties of the Board, MCERA's investment consultant and MCERA's investment managers. The Board makes revisions to the Investment Policy as necessary.

Pursuant to the Investment Policy, the basic goal of MCERA's investment program is to obtain a fully funded plan status, while assuming a risk posture consistent with the Board's risk tolerance. In pursuing this goal, the Board has adopted a long-term investment horizon in which the chances and duration of investment losses are carefully weighed against the long-term potential for appreciation of assets. The primary investment objective is to exceed the actuarial assumption for return on assets. The risk assumed in the pursuit of this investment objective must be appropriate for the return anticipated and consistent with the total diversification of the fund. All transactions undertaken will be for the sole benefit of MCERA's members and beneficiaries and for the exclusive purpose of providing benefits to them, minimizing contributions to the Plan and defraying reasonable associated administrative expenses.

The asset allocation plan adopted by the Board is an integral part of MCERA's investment program. It is designed to provide an optimum, diversified mix of asset classes with return expectations to satisfy expected liabilities, while minimizing risk exposure.

**INVESTMENT RETURNS
FOR THE YEAR ENDED JUNE 30, 2013**

	Market Value	% of Assets	Current Yr Return	3 Year Return	5 Year Return
Domestic Equities	156,732,921	40.87%	23.76%	18.40%	7.72%
Russell 3000 Index			21.46%	18.63%	7.25%
Large Cap Equities	106,837,378	27.86%			
Selected American	11,706,415	3.05%	21.14%	14.77%	4.73%
Investment Co of America	12,255,781	3.20%	20.38%	16.14%	6.15%
S&P 500 Index			20.60%	18.45%	7.01%
Dodge & Cox Stock	22,888,360	5.97%	30.61%	19.24%	6.67%
Robeco	19,198,948	5.01%	28.57%	-	-
S&P 500 Index			20.60%	18.45%	7.01%
Russell 1000 Value Index			25.32%	18.51%	6.67%
Harbor Cap Appreciation	19,788,912	5.16%	14.16%	16.74%	6.85%
Janus Research	20,998,962	5.48%	22.05%	17.36%	6.59%
S&P 500 Index			20.60%	18.45%	7.01%
Russell 1000 Growth Index			17.07%	18.68%	7.47%
Mid Cap Equities	19,618,106	5.12%			
Fidelity Low Priced Stock	4,929,965	1.29%	27.05%	19.10%	9.80%
Royce Total Return	4,851,256	1.26%	24.11%	16.65%	7.76%
Russell 2000 Index			24.21%	18.67%	8.77%
Russell MidCap Value Index			27.65%	19.53%	8.87%
Morgan Stanley	4,831,131	1.26%	17.94%	15.38%	7.70%
Janus Enterprise	5,005,755	1.31%	22.32%	19.49%	7.13%
Russell MidCap Growth Index			22.88%	19.53%	7.61%
Small Cap Equities	21,210,284	5.53%			
Prudential Small Cap Value	11,295,007	2.95%	25.49%	-	-
US Small Cap Value Index			25.79%	18.30%	10.04%
Russell 2000 Value Index			24.76%	17.33%	8.59%
Alliance US Small Growth	5,223,101	1.36%	20.63%	24.89%	11.69%
RS Investments	4,692,176	1.22%	27.45%	21.46%	10.73%
Russell 2000 Growth Index			23.67%	19.97%	8.89%
Micro Cap Equities	9,067,152	2.36%			
Managers Inst Micro Cap	9,067,152	2.36%	29.30%	21.81%	11.60%
Russell Microcap Index			25.38%	18.28%	8.53%
Russell Micro Growth Index			25.67%	19.33%	8.96%

Investment Section

	Market Value	% of Assets	Current Yr Return	3 Year Return	5 Year Return
International Equities	97,299,025	25.37%	16.87%	8.78%	1.90%
EuroPacific	18,506,489	4.83%	15.89%	9.44%	1.46%
Harbor International	18,116,355	4.72%	14.21%	11.01%	0.70%
Columbia Acorn Int'l	9,611,637	2.51%	18.39%	12.41%	3.99%
Janus Overseas	16,082,019	4.19%	8.76%	(3.29%)	(3.55%)
Oakmark International	16,776,036	4.37%	34.59%	14.35%	9.92%
Mondrian International	18,206,490	4.75%	12.45%	-	-
MSCI EAFE Index			18.62%	10.04%	(0.63%)
MSCI ACWI ex-US Index			14.14%	8.48%	(0.34%)
Domestic Fixed Income	93,171,941	24.29%	1.66%	4.53%	6.58%
Dodge & Cox Income	45,819,358	11.95%	2.14%	4.69%	7.08%
PIMCO	47,352,583	12.35%	1.21%	4.67%	-
BC Aggregate Index			(0.69%)	3.51%	5.19%
Real Estate	33,858,782	8.83%	10.71%	15.67%	1.53%
RREEF Public Fund	6,799,442	1.77%	6.87%	17.86%	6.94%
NAREIT			9.22%	17.79%	7.71%
RREEF Private Fund	14,567,844	3.80%	12.09%	15.79%	(0.96%)
Cornerstone Patriot Fund	11,627,497	3.03%	10.11%	-	-
NFI-ODCE Equal Weight Index			10.80%	13.80%	(1.53%)
625 Kings Court	864,000	0.23%	30.05%	5.74%	3.85%
Cash	2,459,096	0.64%			
Total Fund	383,521,766	100.00%	14.52%	11.36%	5.71%
Total Fund Benchmark*			12.29%	11.59%	5.10%

Note: The 1, 3 & 5 year returns are from the Callan Associates performance report dated June 30, 2013. Returns are reported Net of Fees and are calculated on a time-weighted basis.

* Current Quarter Target= 38.0% Russell 3000 Index, 28.0% Barclays Aggregate Index, 25.0% MSCI ACWI ex-US Index, 7.2% NFI-ODCE Equal Weight Net and 1.8% NAREIT.

Asset Allocation

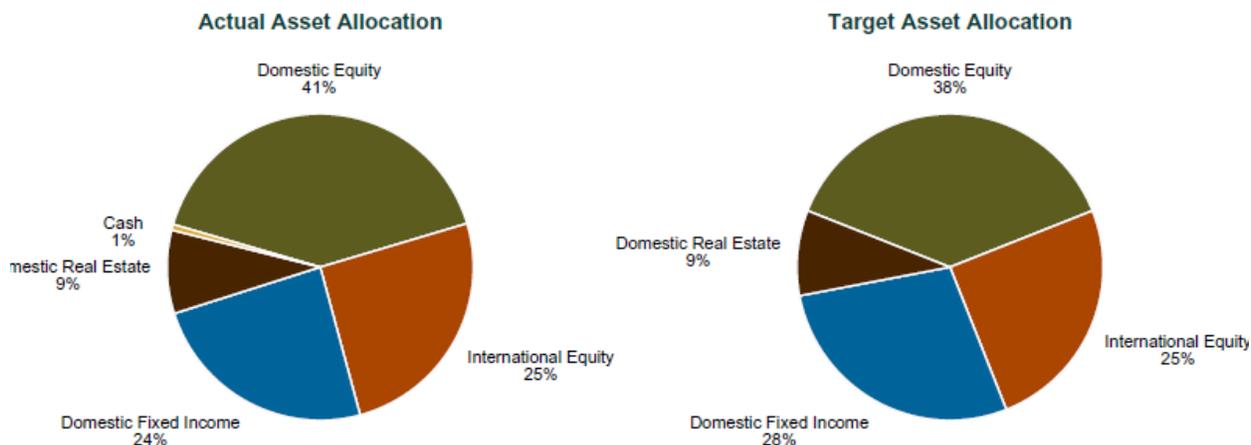
The Board reviews the Association’s investment results each quarter. Periodically, the Board reviews the asset allocation, taking into consideration the latest actuarial study. Based on this review, the Board adopts an asset allocation mix with the goal of helping the Association achieve a fully funded status. Each asset class has a target allocation. The Association treats these targets as long-term funding objectives. Adhering to these targets allows the Association to keep investment risk at a manageable level and minimizes investment costs.

One keystone of asset allocation is diversification among asset classes. Diversification helps to maintain risk at a tolerable level. Therefore, the Board reviews the investment performance and volatility of each asset class on a regular basis over various time periods (quarterly, annually, multi-year) to ensure that the current allocation continues to meet the Association’s needs.

Over time, the Board implements the asset allocation plan by hiring investment managers to invest assets on behalf of the Association, subject to investment guidelines incorporated into each firm’s investment management contract.

TARGET ASSET VS. ACTUAL ASSET ALLOCATION

The top left chart shows the Fund’s asset allocation as of June 30, 2013. The top right chart shows the Fund’s target asset allocation as outlined in the investment policy statement. The bottom chart ranks the fund’s asset allocation and the target allocation versus the Public Fund Sponsor Database.



Asset Class	\$000s Actual	Percent Actual	Percent Target	Percent Difference	\$000s Difference
Domestic Equity	156,733	40.9%	38.0%	2.9%	10,995
International Equity	97,299	25.4%	25.0%	0.4%	1,419
Domestic Fixed Income	93,172	24.3%	28.0%	(3.7%)	(14,214)
Domestic Real Estate	33,859	8.8%	9.0%	(0.2%)	(658)
Cash	2,459	0.6%	0.0%	0.6%	2,459
Total	383,522	100.0%	100.0%		

ASSET ALLOCATION
JUNE 30, 2013 ⁽¹⁾

<u>Asset Class</u>	<u>Market Value</u>	<u>Actual Allocation</u>	<u>Target Allocation</u>
Domestic Equities	156,732,921	40.87%	38.00%
International Equities	97,299,025	25.37%	25.00%
Domestic Fixed Income	93,171,941	24.29%	28.00%
Domestic Real Estate	33,858,782	8.83%	9.00%
Cash	2,459,096	0.64%	0.00
Total Portfolio	383,521,766	100.00%	100.00%

Notes:

⁽¹⁾ Does include cash. Does not include accounts receivables, or prepaid expenses

SCHEDULE OF INVESTMENT MANAGEMENT FEES
AND OTHER INVESTMENT EXPENSES
For the Year ended June 30, 2013

Investment Management Fees:		\$ 2,479,174
Large Cap Funds	\$ 512,819	
Mid Cap Funds	\$ 156,945	
Small/Micro Funds	\$ 302,774	
International Equity Funds	\$ 758,932	
Fixed Income Funds	\$ 419,274	
Real Estate	\$ 328,430	
Investment Consultant Fees		\$ 144,200
Investment Custodial Fees		-0-
Actuary Fees		\$98,851
Other Investment Expense		-0-
Total Investment Expenses		\$2,722,225

LIST OF INVESTMENT MANAGERS

Large Cap Equity

Selected American
Investment Co. of America
Dodge & Cox Stock
Robeco
Harbor Capital Appreciation
Janus Research

Mid Cap Equity

Fidelity Low Priced Stock
Royce Total Return
Morgan Stanley
Janus Enterprise

Small Cap Equity

Prudential Small Cap Value
Alliance US Small Growth
R S Investments
Managers Inst Micro Cap

International Equity

Europacific
Harbor International
Columbia Alcorn International
Janus Overseas
Oakmark International
Mondrian International

Fixed Income

Dodge & Cox Income
PIMCO

Real Estate

RREEF Commingled Fund
RREEF America REIT II
Cornerstone Patriot Fund

Actuarial Section





THE SEGAL COMPANY
100 Montgomery Street Suite 500 San Francisco, CA 94104-4308
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February 7, 2014

Board of Retirement
Mendocino County Employees' Retirement Association
625-B Kings Court
Ukiah, CA 95482-5027

Re: Actuarial Valuation for the Mendocino County Employees' Retirement Association

Dear Members of the Board:

Segal Consulting (Segal) prepared the June 30, 2013 actuarial valuation of the Mendocino County Employees' Retirement Association. We certify that the valuation was performed in accordance with generally accepted actuarial principles and practices. In particular, it is our understanding that the assumptions and methods used for funding purposes meet the parameters of the Governmental Accounting Standards Board Statement No. 25.

As part of the June 30, 2013 actuarial valuation, Segal conducted an examination of all participant data for reasonableness. Summaries of the employee data used in performing the actuarial valuations over the past several years are provided in our valuation report. We did not audit the Association's financial statements. For actuarial valuation purposes, Plan assets are valued at actuarial value. Under this method, the assets used to determine employer contribution rates take into account market value by recognizing the differences between the total return at market value and the expected investment return on market value over a five-year period. The full value of market fluctuations is not recognized in a single year and, as a result, the asset value and the plan costs are more stable.

One of the general goals of an actuarial valuation is to establish rates which, over time, will remain level as a percentage of payroll unless plan benefit provisions are changed. Actuarial funding is based on the Entry Age Cost Method. Under this method, the employer contribution rate provides for current cost (normal cost) plus a level percentage of payroll to amortize any unfunded actuarial accrued liability (UAAL).

Benefits, Compensation and HR Consulting Offices throughout the United States and Canada



Founding Member of the Multinational Group of Actuaries and Consultants, a global affiliation of independent firms



In the June 30, 2013 valuation, we applied the Board's funding policy to amortize the outstanding balance of the Association's unfunded actuarial accrued liability (UAAL) from the June 30, 2012 valuation over a declining period, with 26 years remaining as of June 30, 2013. In addition, any new UAAL established after June 30, 2012 has been amortized over separate layers with different amortization periods depending on the source of the layer (gains and losses are amortized over 18 years).

A listing of supporting schedules Segal prepared for inclusion in the Actuarial and Financial Sections of the Association's CAFR is provided below:

1. Summary of Assumptions and Funding Method;
2. Schedule of Active Member Valuation Data;
3. Schedule of Retirees and Beneficiaries Added To and Removed From Retiree Payroll;
4. Solvency Test;
5. Actuarial Analysis of Financial Experience;
6. Development of Actuarial Value of Assets; and
7. Summary of Plan Provisions.

The valuation assumptions included in the Actuarial Section were adopted by the Retirement Board based on our recommendations following the June 30, 2011 Experience Analysis. It is our opinion that the assumptions used in the June 30, 2013 valuation produce results, which, in the aggregate, reflect the future experience of the Plan. Actuarial valuations are performed on an annual basis. An experience analysis is performed every three years. The next experience analysis is due to be performed as of June 30, 2014.

In the June 30, 2013 valuation, the ratio of the valuation assets to actuarial accrued liabilities increased from 74.1% to 74.2%. The employer's aggregate contribution rate has increased from 25.48% of payroll to 26.28% of payroll. The employee's aggregate rate has increased from 9.60% of payroll to 9.62% of payroll due to a change in membership demographics.

In the June 30, 2013 valuation, the actuarial value of assets excluded \$584,000 in deferred investment gains, which represent 0.2% of the market value of assets. If these deferred investment gains were recognized immediately in the actuarial value of assets, the funded percentage would increase from 74.2% to 75.1%¹ and the aggregate employer contribution rate, expressed as a percentage of payroll, would decrease from 26.28% to about 25.7%.

¹ Assumes that the balance in the Contingency Reserve would be included in the valuation value of assets.

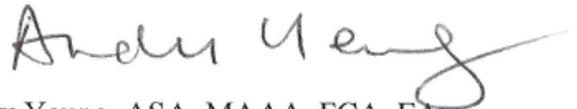
Board of Retirement
Mendocino County Employees' Retirement Association
February 7, 2014
Page 3

The undersigned are Members of the American Academy of Actuaries and meet the qualification requirements to render the actuarial opinion contained herein.

Sincerely,



Paul Angelo, FSA, MAAA, FCA, EA
Senior Vice President & Actuary



Andy Yeung, ASA, MAAA, FCA, EA
Vice President & Associate Actuary

JRC/bqb
Enclosures

Actuarial Section

SUMMARY OF ASSUMPTIONS AND FUNDING METHOD

The Entry Age Actuarial Cost Method was used in conjunction with the following actuarial assumptions. The funding policy adopted by the Board is to amortize the Association's outstanding balance of the unfunded actuarial accrued liability (UAAL) from the June 30, 2012 valuation over a declining period, with 26 years remaining as of June 30, 2013. In addition, any new UAAL established after June 30, 2012 has been amortized over separate layers with different amortization periods depending on the source of the layer (gains and losses are amortized over 18 years). The Board has continued the following economic assumptions for the June 30, 2013 valuation:

ASSUMPTIONS

Valuation Interest Rate	7.75%
Inflation Rate	3.50%
Across the Board Salary Increase	0.50%
Interest Credited to Member Accounts	7.75%
Consumer Price Index	Increases of 3.50% per year, retiree COLA increases due to CPI for General Tiers 1, 2, and 3, Safety Tiers 1 and 2, and Probation Tiers 1 and 2 subject to a 3% maximum change per year (no COLA increases for General Tier 4, Safety Tier 3, or Probation Tier 3)
Cost-of-Living Adjustments	3.00% of retirement income for General Tiers 1, 2, and 3, Safety Tiers 1 and 2, and Probation Tiers 1 and 2
Asset Valuation	Smoothed actuarial value

The following demographic and salary increase assumptions were used for the actuarial valuation as of June 30, 2013. The assumptions were selected by the actuary and approved by the Board.

Post-Retirement Mortality

(a) *Healthy*

General Members

RP-2000 Combined Healthy Mortality Table for Males and Females set back two years for males and set back one year for females.

Safety and Probation Members

RP-2000 Combined Healthy Mortality Table for Males and Females with no setback for males and set forward one year for females.

All Beneficiaries

Same as General Members.

(b) *Disabled*

General Members

RP-2000 Combined Healthy Mortality Table for Males and Females set forward two years.

Safety and Probation Members

RP-2000 Combined Healthy Mortality Table for Males and Females set forward four years.

(c) *For Employee Contribution Rate Purposes*

General Members

RP-2000 Combined Healthy Mortality Table for Males and Females set back two years for males and set back one year for females, weighted 30% male and 70% female.

Safety and Probation Members

RP-2000 Combined Healthy Mortality Table for Males and Females with no setback for males and set forward one year for females, weighted 80% male and 20% female.

Pre-Retirement Mortality

(a) *General Members*

RP-2000 Combined Healthy Mortality Table for Males and Females set back two years for males and set back one year for females.

(b) *Safety and Probation Members*

RP-2000 Combined Healthy Mortality Table for Males and Females with no setback for males and set forward one year for females.

Termination Rates

Disability Rates

Based upon the Experience Analysis as of 6/30/2011 (Table 1).

Service Retirement Rates

Based upon the Experience Analysis as of 6/30/2011 (Table 1).

Reciprocity Assumption

60% of members who terminate with a vested benefit are assumed to enter a reciprocal system. For reciprocals, 4.50% compensation increases per annum are assumed.

Salary Scales

As shown in Table 2.

Spouses and Dependents

80% of male employees and 50% of female employees assumed married at retirement, with wives assumed three years younger than husbands.

ASSUMPTIONS (continued)

Deferred Vested Retirement Age

60 for General members; 55 for Safety and Probation members. For future deferred vested members who terminate with less than five years of service and are not vested, it is assumed they will retire at age 70 if they decide to leave their contributions on deposit.

Future Benefit Accruals

1.0 year of service per year of employment plus 0.019 years of additional service to anticipate conversion of unused sick leave for each year of employment, for members expected to retire directly from active employment and to receive a service retirement benefit.

Actuarial Section
PROBABILITIES OF SEPARATION FROM ACTIVE SERVICE - TABLE 1

General Members						
Years of Service	Termination ⁽¹⁾ (Less Than 5 Years of Service)					
0	.1450					
1	.1150					
2	.1050					
3	.0950					
4	.0850					
Age	Termination ⁽¹⁾ (5+ Years of Service)	Mortality Male ⁽²⁾	Mortality Female ⁽²⁾	Disability ⁽⁴⁾	Service Tiers 1, 2, & 3	Service Tier 4
20	.0450	.0003	.0002	.0001	.0000	.0000
30	.0450	.0004	.0002	.0002	.0000	.0000
40	.0450	.0010	.0006	.0006	.0000	.0000
50	.0450	.0019	.0016	.0053	.0500	.0000
60	.0220	.0053	.0044	.0074	.1000	.0600

Safety and Probation Members							
Years of Service	Termination ⁽¹⁾ (Less Than 5 Years of Service)						
0	.1100						
1	.0950						
2	.0750						
3	.0650						
4	.0550						
Age	Termination ⁽¹⁾ (5+ Years of Service)	Mortality Male ⁽³⁾	Mortality Female ⁽³⁾	Disability ⁽⁵⁾	Service Tiers 1 & 2	Service Safety Tier 3	Service Probation Tier 3
20	.0500	.0003	.0002	.0020	.0000	.0000	.0000
30	.0390	.0004	.0003	.0034	.0000	.0000	.0000
40	.0320	.0011	.0008	.0114	.0000	.0000	.0000
50	.0110	.0021	.0019	.0248	.0500	.0300	.0400
60	.0000	.0067	.0058	.0000	1.000	1.000	1.000

- (1) For members with less than five years of service, 85% of all terminated members will choose a refund of contributions and 15% will choose a deferred vested benefit. For members with five or more years of service, 25% of all terminated members will choose a refund of contributions and 75% will choose a deferred vested benefit. No termination is assumed after a member is eligible for retirement.
- (2) 10% of General deaths are assumed to be service connected deaths. The other 90% are assumed to be non-service connected deaths.
- (3) 50% of Safety and Probation deaths are assumed to be service connected deaths. The other 50% are assumed to be non-service deaths.
- (4) 50% of General disabilities are assumed to be service connected disabilities. The other 50% are assumed to be non-service connected disabilities.
- (5) 90% of Safety and Probation disabilities are assumed to be service connected disabilities. The other 10% are assumed to be non-service connected disabilities.

The probabilities shown for each cause of separation represent the likelihood that a given member will separate at a particular age for the indicated reason. For example, if the probability of termination of a General member at age 30 with at least 5 years of service is 0.0450, then we are assuming that 4.50% of the active General members at age 30 with at least 5 years of service will terminate with vested rights during the next year.

ACTUARIAL ASSUMPTIONS FOR MERIT AND PROMOTIONAL SALARY INCREASE RATES - TABLE 2

Consists of the sum of three parts: A uniform inflation component of 3.50%; plus “across the board” salary increases of 0.50% per year; plus a service-related component for merit and promotion, summarized as follows:

Years of Service	General Members	Safety and Probation Members
0	5.00%	5.00%
1	3.75%	3.75%
2	3.50%	3.00%
3	2.75%	2.25%
4	2.25%	1.00%
5+	0.50%	0.50%

SCHEDULE OF ACTIVE MEMBER VALUATION DATA ⁽¹⁾

Valuation Date	Plan Type	Number	Annual Payroll \$	Monthly Average Pay \$	Percentage of Increase in Average Pay ⁽²⁾
6/30/2008	General	1,207	59,194,561	4,087	6.4%
	Safety	156	9,157,574	4,892	5.5%
	Probation	47	2,528,198	4,483	7.5%
	Total	1,410	70,880,333	4,189	6.4%
6/30/2009	General	1,164	60,045,883	4,299	5.2%
	Safety	143	9,057,202	5,278	7.9%
	Probation	62	3,132,010	4,210	-6.1%
	Total	1,369	72,235,095	4,397	5.0%
6/30/2010 ⁽³⁾	General	1,071			
	Safety	130			
	Probation	53			
	Total	1,254	69,004,002 ⁽⁴⁾	4,586 ⁽⁴⁾	4.3%
6/30/2011	General	955	53,294,624	4,650	
	Safety	122	8,238,933	5,628	
	Probation	52	2,610,208	4,183	
	Total	1,129	64,143,765	4,735	-0.7% ⁽⁵⁾
6/30/2012	General	895	45,850,427	4,269	-8.2%
	Safety	120	8,021,174	5,570	-1.0%
	Probation	54	2,724,487	4,204	0.5%
	Total	1,069	56,596,088	4,412	-6.8%
6/30/2013	General	894	45,512,393	4,242	-0.6%
	Safety	123	8,169,530	5,535	-0.6%
	Probation	55	2,782,060	4,215	0.3%
	Total	1,072	\$56,463,983	4,389	-0.5%

⁽¹⁾ Information for 6/30/2008 - 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.

⁽²⁾ Reflects the increase in average salary for members at the beginning of the year versus those at the end of the year. It does not reflect the average individual salary increases received by members who worked the full year.

⁽³⁾ The payroll information presented in this schedule is not separated by plan type in the previous actuary's June 30, 2010 valuation report.

⁽⁴⁾ Based on Segal's June 30, 2011 valuation report, total compensation, including a projection for expected salary increases during 2010/2011 under the actuarial assumptions used in the valuation, is \$71,729,795. Monthly average pay with the projection equates to \$4,767.

⁽⁵⁾ Determined using Segal's calculation of monthly average pay with projection as of June 30, 2010 (i.e., \$4,767, pursuant to footnote 4 above).

SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM RETIREE PAYROLL⁽¹⁾

Valuation Date	Added to Rolls		Removed from Rolls		Rolls-End of Year		Increase in Annual Allowances	Average Annual Allowances
	No.	Annual Allowances	No.	Annual Allowances	No.	Annual Allowances		
6/30/2008	82	\$1,624,000	27	\$252,000	962	\$16,199,000	9.3%	\$16,839
6/30/2009	77	1,921,000	31	352,000	1,008	17,768,000	9.7%	17,627
6/30/2010 ⁽²⁾					1,083	19,125,661 ⁽³⁾	7.6%	17,660
6/30/2011	71	1,624,933	25	205,558 ⁽⁴⁾	1,129	21,296,641	7.1% ⁽⁴⁾	18,863
6/30/2012	108	2,599,055	20	388,743	1,217	23,506,953	10.4%	19,315
6/30/2013	111	2,742,843	41	596,482	1,287	25,653,314	9.1%	19,933

Note: Statutory COLAs are included in the "Added to Rolls" column.

- (1) Information from 6/30/2008 - 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.
- (2) Information regarding members added to and removed from roll was not provided in the previous actuary's June 30, 2010 valuation report.
- (3) This is the amount shown in the previous actuary's June 30, 2010 valuation report. Segal subsequently revised this amount to be \$19,877,266 (which equates to an average annual allowance of \$18,354) to correct for the annualization of the current service portion of the benefit for beneficiary records.
- (4) Determined using Segal's corrected annual allowance as of 6/30/2010 of \$19,877,266.

SOLVENCY TEST⁽¹⁾

(Dollars in Thousands)

Valuation Date	Aggregate Accrued Liabilities for			Total	Portion of Accrued Liabilities Covered by Reported Assets			
	(1)	(2)	(3)		Actuarial Value of Assets	(1)	(2)	(3)
	Active Member Contributions	Retired/Vested Members	Active Members (Employer Financed Portion)					
6/30/2008	\$62,348	\$199,072	\$112,412	\$373,832	\$353,421	100%	100%	82%
6/30/2009	64,102	218,613	120,481	403,196	336,263	100%	100%	44%
6/30/2010 ⁽²⁾				434,987	343,202			
6/30/2011	53,600	287,201	131,843	472,644	347,732	100%	100%	5%
6/30/2012	51,090	312,531	125,393	489,014	362,487	100%	100%	0%
6/30/2013	51,236	338,874	120,351	510,461	378,777	100%	97%	0%

This exhibit includes actuarially funded liabilities and assets.

- (1) Information as of 6/30/2008 & 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.
- (2) The breakdown of the aggregate accrued liabilities was not provided in the previous actuary's June 30, 2010 valuation report.

Actuarial Section

ACTUARIAL ANALYSIS OF FINANCIAL EXPERIENCE⁽¹⁾ Items Impacting Unfunded Actuarial Accrued Liability (UAAL)

Plan Year Ending 6/30	2013	2012	2011	2010 ⁽²⁾	2009	2008
Beginning of the Year UAAL Liability (Surplus)	\$126,527	\$124,913	\$91,785	\$66,933	\$20,411	\$40,322
Effect of Differences in Methods and Procedures Due to Change in Actuaries	-	-	9,035	-	-	-
Expected Change	3,118	6,929	7,638	-	805	(5,320)
Liability (Gain)/Loss	4,236	1,937	-	-	19,978 ⁽³⁾	2,449 ⁽³⁾
Asset Return (Gain)/Loss	3,046	3,647	15,266	-	29,934	(17,040)
Salary Increase (Gain)/Loss	(5,243)	(13,844)	(11,363)	-	-	-
Retiree COLA Increase (Gain)/Loss	-	-	(5,887)	-	-	-
Change in Actuarial Assumptions and Procedures	-	2,945	24,043	-	-	-
(Gain)/Loss Due to Reflecting Future Service Only Improvement for General Members	-	-	(5,604)	-	-	-
Change in Method to Determine Actuarial Value of Assets	-	-	-	-	(4,195)	-
End of the Year UAAL Liability (Surplus)	\$131,684	\$126,527	\$124,913	\$91,785	\$66,933	\$20,411

(Dollars in Thousands)

⁽¹⁾ Information as of 6/30/2008 & 6/30/2009 has been extracted from MCERA's June 30, 2009 CAFR. Information as of 6/30/2010 has been extracted from the previous actuary's June 30, 2010 valuation report.

⁽²⁾ The UAAL reconciliation was not provided in the previous actuary's valuation reports.

⁽³⁾ Combined effect of liability (gain)/loss and change in actuarial assumptions.

Actuarial Section
DEVELOPMENT OF ACTUARIAL VALUE OF ASSETS

(Dollars in Thousands)

1. Market value of assets as of June 30, 2013 \$383,197

	Actual Market Return (net)	Expected Market Return (net)	Investment Gain / (Loss)	Deferred Factor	Deferred Return
2. Calculation of deferred return:					
(a) Year ended June 30, 2008	\$(15,554)	\$28,043	\$(43,597)		
(b) Year ended June 30, 2009	(51,893)	26,211	(78,104)		
(c) Year ended June 30, 2010	38,133	21,358	16,774		
(d) Year ended June 30, 2011	64,075	23,640	40,435	50%	\$1,226
(e) Year ended June 30, 2012	(4,078)	27,197	(31,275)	60%	(18,765)
(f) Year ended June 30, 2013	48,890	26,235	22,655	80%	<u>18,124</u>
(g) Total unrecognized return					\$584
3. Preliminary actuarial value of assets as of June 30, 2013: (1) – (2g)					\$382,612
4. Adjustment to be within 25% corridor of market value					\$0
5. Final actuarial value of assets as of June 30, 2013: (3) + (4)					\$382,612
6. Actuarial value as a percentage of market value: (5) / (1)					99.8%
7. Non-pension reserves:					
Contingency reserve					\$3,835
8. Valuation value of assets: (5) – (7)					\$378,777

Actuarial Value of Assets:

For purposes of calculating the required contribution rates for the valuation, a modified market value of the fund's assets is used. Under this approach, recognition is given each year to total earnings of the fund to date. The current method adjusts market value to recognize, over a five-year period, differences between assumed and actual investment return.

⁽¹⁾ Based on action taken by the Board in 2012, the total deferred return through June 30, 2011 has been recognized in four level amounts, with two years of recognition remaining after the June 30, 2013 valuation.

Note: Amounts may not total exactly due to rounding.

Actuarial Section
SUMMARY OF PLAN PROVISIONS

Briefly summarized below are the major provisions of the County Employees' Retirement Law of 1937, as amended through June 30, 2013.

Membership

Membership usually begins with the first day of the pay period following the date of entrance into service.

Final Compensation

For General, Safety, and Probation Tiers 1, final compensation is defined as the highest consecutive twelve months of compensation earnable. For General Tiers 2 and 3, and Safety and Probation Tiers 2, final compensation is defined as the highest consecutive thirty-six months of compensation earnable. For General Tier 4, and Safety and Probation Tiers 3, final compensation is defined as the highest consecutive thirty-six months of pensionable compensation.

Return of Contributions

If a member should resign or die before becoming eligible for retirement, his or her contribution plus interest may be refunded. In lieu of receiving a return of contributions, a member may elect to leave his or her contributions on deposit. Members with five years of service may choose to receive a deferred vested benefit when eligible for retirement.

Service Retirement Benefit

For General Tiers 1, 2, and 3, and Safety and Probation Tiers 1 and 2, members are eligible to retire at age 50 with 10 years of service, or age 70 regardless of service, or after 30 years of service (20 years for Safety and Probation), regardless of age. For General Tier 4, members are eligible to retire at age 52 with 5 years of service or age 70 regardless of service. For Safety and Probation Tiers 3, members are eligible to retire at age 50 with 5 years of service or age 70 regardless of service.

Basis of Benefit Payments

Benefits are based upon a combination of age, years of service, final compensation, and the benefit payment option selected by the member. For General Tiers 1, 2, and 3, and Safety and Probation Tiers 1 and 2, the maximum benefit payable to a member or beneficiary is 100% of final compensation. For General Tier 4, and Safety and Probation Tiers 3, there is no maximum benefit.

Cost of Living Benefit

For General Tiers 1, 2, and 3, and Safety and Probation Tiers 1 and 2, future cost of living benefit changes are based on the Consumer Price Index (CPI) up to a

maximum of 3% per year. Any excess CPI is "banked." There are no cost of living benefits for General Tier 4, Safety Tier 3, and Probation Tier 3.

Disability Benefit

Members with 5 years of service, regardless of age, are eligible for a non-service connected disability. The benefit is 1.8% of final compensation for each year of service. Generally, the maximum benefit is 1/3 of final compensation. The benefit for a service connected disability is the greater of 50% of final compensation or the service retirement benefit (if eligible).

Death Benefit - Prior to Retirement

In addition to the return of contributions, a death benefit is payable to the member's beneficiary or estate equal to one month's salary for each completed year of service under the retirement system. The death benefit is based on the salary earned during the last twelve months preceding the member's death, but not to exceed 6 month's salary.

If a member dies while eligible for service retirement or non-service connected disability, his or her spouse or domestic partner receives 60% of the allowance that the member would have received for retirement on the day of his or her death.

If a member dies in the performance of duty, the spouse or domestic partner will receive a lifetime benefit equal to 50% of the member's final compensation or a service retirement benefit whichever is higher.

Death Benefit - After Retirement

As part of the retirement process, members are required to select among several options for benefits continuation upon the member's death. For married retirees, the most common retirement option is the unmodified option, which pays the retiree's eligible spouse or domestic partner a lifetime benefit equal to 60% of the benefit the retiree was receiving.

Member's Contributions

Contribution rates for the employer and its covered employees are established and may be amended by the MCERA Board of Retirement, and then adopted by the County Board of Supervisors. The contribution rates are determined based on the benefit structure established by the employer. For General Tiers 1, 2, and 3, and Safety and Probation Tiers 1 and 2, members are required to contribute a percentage of their annual covered salary and their particular contribution rate is based upon age at entry into the Association. For General Tier 4, and Safety and Probation Tiers 3, members are required to

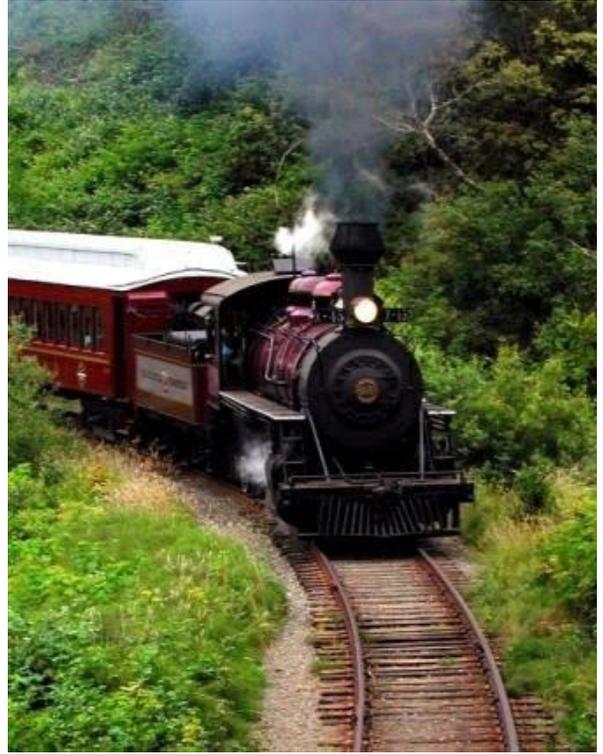
Actuarial Section

Member's Contributions (continued)

contribute at least 50% of the Normal Cost rate. The employer is required to contribute the remaining amount necessary to finance the coverage of their employees through periodic contributions at actuarially determined rates.

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Statistical Section



This Section provides additional detailed information in order to promote a more comprehensive understanding of this year’s financial statements, note disclosures, and supplemental information. In addition, this section provides multiyear trends of the financial and operation information in order to facilitate the understanding of how the organization’s financial position and performance have changed over time. This section provides contextual data for MCERA’s changes in nets assets, benefit expenses, retirement types benefit payments and membership data.

**SCHEDULE OF CHANGES IN NET ASSETS
(Last Ten Fiscal Years)**

(Dollars in Thousands)	2013	2012	2011	2010	2009
Additions					
Employer Contributions	\$ 14,260	\$ 11,811	\$ 9,554	\$ 8,234	\$ 8,561
Member Contributions	4,713	4,840	5,447	6,502	6,836
Net Investment Income	48,890	(4,078)	64,075	38,128	(52,214)
Total Additions	67,863	12,573	79,076	52,864	(36,817)
Deductions					
Benefits Payments	25,500	22,955	22,269	23,161	21,480
Refunds of Contributions	1,073	1,225	1,167	1,061	734
Health Benefits ⁽¹⁾	-	-	-	-	-
Administrative Expenses	830	698	640	641	280
Total Deductions	27,403	24,879	24,076	24,863	22,494
Change in Plan Net Assets	\$40,460	\$(12,306)	\$ 55,000	\$ 28,001	\$(59,311)

(Dollars in Thousands)	2008	2007	2006	2005	2004
Additions					
Employer Contributions	\$ 7,269	\$ 7,231	\$ 6,464	\$ 6,481	\$ 6,299
Member Contributions	6,613	6,002	5,998	6,618	6,649
Net Investment Income	(15,846)	52,299	32,079	24,019	34,487
Total Additions	(1,964)	65,532	44,541	37,118	47,435
Deductions					
Benefits Payments	15,640	14,153	12,878	11,269	10,234
Refunds of Contributions	1,064	1,036	1,068	933	728
Health Benefits	4,017	3,382	3,410	2,680	2,759
Administrative Expenses	134	119	82	40	158
Total Deductions	20,855	18,690	17,438	14,922	13,879
Change in Plan Net Assets	\$(22,819)	\$ 46,842	\$ 27,103	\$ 22,196	\$33,556

⁽¹⁾ For years 2009 – 2011, amounts for health benefits are included in benefit payments.

REVENUE BY SOURCE

(Dollars in Thousands)

Fiscal Year Ended 6/30	Employee Contributions	Employer/Other Contributions	Investment Net Income	Total
2004	6,649	6,299	34,487	47,435
2005	6,618	6,481	24,019	37,118
2006	5,998	6,464	32,079	44,541
2007	6,002	7,231	52,299	65,532
2008	6,613	7,269	(15,846)	(1,964)
2009	6,836	8,561	(52,214)	(36,817)
2010	6,502	8,234	38,128	52,864
2011	5,447	9,554	64,075	79,076
2012	4,840	11,811	(4,078)	12,573
2013	4,713	14,260	48,890	67,863

EXPENSES BY TYPE

(Dollars in Thousands)

Fiscal Year Ended 6/30	Benefits	Administrative/ Other Expenses	Refunds	Total
2004	10,234	2,917	728	13,879
2005	11,269	2,720	933	14,922
2006	12,878	3,492	1,068	17,438
2007	14,153	3,501	1,036	18,690
2008	15,640	4,151	1,064	20,855
2009	21,480	280	734	22,494
2010	23,161	641	1,061	24,863
2011	22,269	640	1,167	24,076
2012	22,955	698	1,225	24,879
2013	25,500	830	1,073	27,403

SCHEDULE OF BENEFIT EXPENSES BY TYPE

(Dollars in Thousands)

	2013	2012	2011⁽¹⁾	2010	2009
Service Retirement Payroll:					
General	16,253	14,864	13,197	12,112	10,808
Safety	3,215	2,500	2,477	2,267	1,799
Total	19,468	17,364	15,674	14,379	12,607
Disability Retirement Payroll:					
General	2,128	2,074	1,987	1,970	1,815
Safety	2,030	1,903	1,832	1,823	1,654
Total	4,158	3,977	3,819	3,793	3,469
Beneficiary Payroll:					
General	1,485	1,487	1,335	679	1,269
Safety	524	485	471	275	422
Total	2,027	1,972	1,806	954	1,691
Total Benefit Expense:					
General	19,865	18,425	16,519	14,761	13,892
Safety	5,787	4,889	4,780	4,365	3,875
Total	\$ 25,692	\$ 23,313	\$ 21,299	\$ 19,126	\$ 17,767

(Dollars in Thousands)

	2008	2007	2006	2005	2004
Service Retirement Payroll:					
General	9,960	8,688	7,855	7,321	6,143
Safety	1,664	1,532	1,129	822	563
Total	11,624	10,220	8,984	8,143	6,706
Disability Retirement Payroll:					
General	1,751	1,683	1,566	1,410	1,273
Safety	1,590	1,432	1,346	1,176	1,113
Total	3,341	3,115	2,912	2,586	2,386
Beneficiary Payroll:					
General	1,171	1,138	1,001	971	886
Safety	404	359	352	314	297
Total	1,575	1,497	1,353	1,285	1,183
Total Benefit Expense:					
General	12,882	11,509	10,422	9,702	8,302
Safety	3,658	3,323	2,827	2,312	1,973
Total	\$ 16,540	\$ 14,832	\$ 13,249	\$ 12,014	\$ 10,275

⁽¹⁾ Estimated Based upon Annualized Benefit Amounts as of June 30, 2011.

Source of Data: Actuarial Valuation Reports (2004 – 2013)

**SCHEDULE OF RETIREE MEMBERS BY TYPE OF BENEFIT
(Summary of Monthly Allowances Being Paid – As of June 30, 2013)**

(Dollars in Thousands)

2012	General Members		Safety Members		Total	
	Number	Monthly Allowance	Number	Monthly Allowance	Number	Monthly Allowance
Retired Members						
Service Retirement	822	\$ 1,239	83	\$ 208	905	\$ 1,447
Disability	114	173	56	159	170	332
Beneficiaries	113	124	29	40	142	164
Total Retired Members	1,049	\$ 1,536	168	\$ 407	1,217	\$ 1,943

(Dollars in Thousands)

2013	General Members		Safety Members		Total	
	Number	Monthly Allowance	Number	Monthly Allowance	Number	Monthly Allowance
Retired Members						
Service Retirement	874	\$ 1,354	99	\$ 268	973	\$ 1,622
Disability	113	177	57	169	170	346
Beneficiaries	113	124	31	45	144	169
Total Retired Members	1100	\$ 1,655	187	\$ 482	1,287	\$ 2,137

Source of data: June 30, 2012 and June 30, 2013 Actuarial Valuation Report

SCHEDULE OF AVERAGE BENEFIT PAYMENT AMOUNTS

	Number of Years Since Retirement						
	0-4	5-9	10-14	15-19	20-24	25-29	30 +
Valuation date 06/30/13							
Average Monthly Benefit	\$ 1,806	\$ 1,799	\$ 1,333	\$ 1,443	\$ 1,686	\$ 1,350	\$ 1,388
Number of Retirees	453	338	167	126	93	60	50
Valuation date 06/30/12							
Average Monthly Benefit	\$ 1,771	\$ 1,683	\$ 1,343	\$ 1,452	\$ 1,613	\$ 1,314	\$ 1,297
Number of Retirees	426	319	151	113	93	70	45
Valuation date 06/30/11							
Average Monthly Benefit	\$ 1,777	\$ 1,577	\$ 1,379	\$ 1,488	\$ 1,429	\$ 1,462	\$ 975
Number of Retirees	396	271	157	126	83	56	40
Valuation date 06/30/10							
Average Monthly Benefit	\$ 1,699	\$ 1,363	\$ 1,361	\$ 1,429	\$ 1,280	\$ 1,324	\$ 1,123
Number of Retirees	387	243	152	123	82	57	39
Valuation date 06/30/09							
Average Monthly Benefit	\$ 1,707	\$ 1,296	\$ 1,361	\$ 1,473	\$ 1,337	\$ 1,135	\$ 1,229
Number of Retirees	371	190	154	117	80	62	34
Valuation date 06/30/08							
Average Monthly Benefit	\$ 1,687	\$ 1,262	\$ 1,302	\$ 1,533	\$ 1,177	\$ 1,150	\$ 1,120
Number of Retirees	356	183	141	103	85	70	22
Valuation date 06/30/07							
Average Monthly Benefit	\$ 1,564	\$ 1,284	\$ 1,288	\$ 1,433	\$ 1,116	\$ 1,061	\$ 967
Number of Retirees	322	171	130	111	88	63	22
Valuation date 06/30/06							
Average Monthly Benefit	\$ 1,454	\$ 1,307	\$ 1,267	\$ 1,276	\$ 1,174	\$ 909	\$ 863
Number of Retirees	275	172	149	104	78	56	18
Valuation date 06/30/05							
Average Monthly Benefit	\$ 1,345	\$ 1,321	\$ 1,293	\$ 1,157	\$ 1,061	\$ 876	\$ 705
Number of Retirees	248	170	142	100	84	51	14
Valuation date 06/30/04							
Average Monthly Benefit	\$ 1,163	\$ 1,219	\$ 1,270	\$ 1,137	\$ 964	\$ 902	\$ 585
Number of Retirees	199	171	134	100	91	42	12

Source of data: Actuarial Valuation Reports (2004 – 2013). Data on Final Average Salary is not available and not included in this table.

SCHEDULE OF PARTICIPATING EMPLOYERS AND ACTIVE MEMBERS
As of June 30

	Total Employees	County of Mendocino	Russian River Cemetery District	Superior Court
Year 2013				
Number of Covered Employees	1,072	1,021	4	47
Percentage to Total System	100%	95.25%	0.37%	4.38%
Year 2012				
Number of Covered Employees	1,069	1,011	4	54
Percentage to Total System	100%	94.57%	.37%	5.05%
Year 2011				
Number of Covered Employees	1,129	1,065	4	60
Percentage to Total System	100%	94.33%	.35%	5.32%
Year 2010				
Number of Covered Employees	1,254	1,186	5	63
Percentage to Total System	100%	94.58%	.40%	5.02%
Year 2009				
Number of Covered Employees	1,369	1,294	5	70
Percentage to Total System	100%	94.52%	.37%	5.11%
Year 2008				
Number of Covered Employees	1,410	1,335	5	70
Percentage to Total System	100%	94.68%	.36%	4.96%
Year 2007				
Number of Covered Employees	1,395	1,314	5	76
Percentage to Total System	100%	94.19%	.36%	5.45%
Year 2006				
Number of Covered Employees	1,312	1,225	5	82
Percentage to Total System	100%	93.37%	.38%	6.25%
Year 2005				
Number of Covered Employees	1,333	1,258	6	69
Percentage to Total System	100%	94.37%	.45%	5.18%
Year 2004				
Number of Covered Employees	1,400	1,338	6	56
Percentage to Total System	100%	95.57%	.43%	4.00%

Source of data: MCERA systems.

END OF REPORT