PUBLIC SAFETY PERSONNEL RETIREMENT SYSTEM



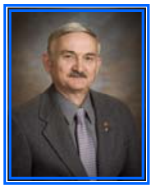
SUMMARY ANNUAL FINANCIAL REPORT

A PENSION TRUST FUND OF THE STATE OF ARIZONA



FOR THE FISCAL YEAR ENDED JUNE 30, 2014


Brian Tobin
Chairman


Gregory Ferguson
Vice Chairman


Jeff McHenry
Trustee


Richard Petrenka
Trustee


Randy Stein
Trustee


Lauren Kingry
Trustee


William Davis
Trustee

BOARD OF TRUSTEES HIGHLIGHTS (BOARD AS OF JUNE 30, 2014)

- Brian Tobin, Chairman, was hired as a Phoenix Firefighter in 1983. He was elected to the United Phoenix Fire Fighters Association as a trustee in 1987. He has been elected to the Phoenix Fire Fighters Pension Board three times. He became Fire Captain in 1994, Battalion Chief in 2004, and Deputy Chief in 2007.
- Greg Ferguson, Vice Chairman, is a graduate of Arizona Western College and Northern Arizona University. He retired from the United States Marine Corps in 1994 after 26 years of service, including a tour in Vietnam. He has performed environmental work with the Yuma Proving Ground and the Arizona Department of Environmental Quality. He is currently serving on the Yuma County Board of Supervisors, where he has served as Chairman and Vice Chairman.
- Jeff McHenry has been a Tempe Police Officer since 1993, and a Police Sargeant since 2004. He is currently assigned to Patrol and is the President of the Tempe Officers Association.
- Richard Petrenka is a graduate of Fairleigh Dickinson University. He served as Arizona Deputy State Treasurer for 16 years. He has also sat on the Boards of the State Water Infrastructure Finance Authority and Greater Arizona Development Authority.
- Randie Stein, a graduate of the University of Arizona, has served as a member of the Senate Staff from 1989-1998. She also served as the Acting Executive Director of the Arizona School Facilities Board and was responsible for the initial implementation of the Students FIRST law.
- Lauren Kingry is the current Superintendent of the Arizona Department of Financial Institutions. He has also previously held CEO positions at Liberty Bank & Trust, Bank of Scottsdale and Valley Capital Bank.
- William Davis is a managing director of the Phoenix public finance group at Piper Jaffray. He provides investment banking and consulting services to many municipal government entities throughout Arizona. He holds the Chartered Financial Analyst designation from the Association for Investment Management and Research .

FISCAL YEAR HIGHLIGHTS

- The Public Safety Personnel Retirement System (PSPRS) had a total rate of return (net of fees) of 13.28% this year. Our total portfolio underperformed the target fund benchmark by 54 basis points. This is an improvement from the prior year's return of 10.64%.
- In compliance with the Supreme Court decision regarding permanent benefit increase (PBI) payments, the Future Benefit Increase Reserve was restored effective FY 2012 for those members who retired effectively on or before July 1, 2011. The retroactive funding of the reserves and the increase for FY 2014, were depleted with the distribution of a retroactive PBI increase and PBI for FY 2014 effective July 1, 2014.
- Retirement benefits paid totaled $625.68 million for the current year, compared to $566.10 for the previous year. This represents a 10.52% increase from the prior year. Normal, survivor, and disability retirement benefits paid increased by $59.58 million.

NEW DEVELOPMENTS AND MANAGEMENT INITIATIVES

Our efforts over the past few years to increase communication and education with our Local Boards have been met with great success in helping them to better understand their duties and roles as administrators of their individual plans. Because of the increasing employer contribution rates and the heavier burden it has created, we have expanded these outreach efforts to focus more intently on the financial professionals and other decision makers at the local level, to assist with understanding the various components of their employer liabilities. Furthermore, we have begun assessing how we can provide broader, more robust communication channels and clear, concise messaging to those employers, our membership, and other interested stakeholders. This includes, but is not limited to, more outreach, website redesign, educational sessions and stakeholder meetings, to name a few.

Additionally, organizational efforts to become more efficient were begun in May by focusing more intently on our internal processes and procedures. To foster this process, construction continues on the *Knowledge|Information Management Portal*, a three-tiered, folder-based system for controlling the PSPRS operational documents and records. The portal enables enhanced organizational planning, execution and reporting. It integrates the processes and groups in the organization to create a uniform approach to document management and records retention, thereby increasing efficiency and strengthening decision making. Our goal over the next three to five years is to achieve *International Organization for Standardization (ISO)* Quality Certifications and apply for the Malcolm Baldrige Quality Award, the highest level of national quality recognition a U.S. organization can receive.

Finally, since late fall of 2013, we have been undergoing our sunset review and performance audit with the Office of the Auditor General. The collaborative relationship we have experienced with the Office over the past year has been very enlightening and is providing additional insight for more efficiencies and improvement. We look forward to the release of their report in fall 2015.

MESSAGE FROM THE ADMINISTRATOR

Jared Smout
Deputy Administrator

Dear Members,

I am pleased to present the PSPRS Summary Annual Financial Report for the fiscal year ended June 30, 2014. This report provides financial information about the System's financial status, investment performance, and highlights significant changes that occurred during the year. The information in this report is derived from the Comprehensive Annual Financial Report (CAFR). To view the full CAFR, please refer to the last page of this report.

HISTORY AND ADMINISTRATION OF THE SYSTEM

The System was created on July 1, 1968 by A.R.S. § 38-841, "to provide a uniform, consistent and equitable statewide program for public safety personnel who are regularly assigned hazardous duty in the employ of the state of Arizona or a political subdivision thereof." PSPRS is an agent multiple-employer defined benefit plan and is administered at the local level by 237 individual Local Boards in accordance with A.R.S. § 38-847. Each Local Board determines eligibility for membership, normal retirement benefits based on years of service, the annual benefit accrual rate and final average compensation; they also determine eligibility for disability benefits, survivor benefits for spouses and children, post-retirement adjustments and health insurance premium subsidies.

The contributions received from and benefits distributed for each local board are accounted for by the Board of Trustees through the administrative offices of the System. However, in accordance with A.R.S. § 38-848, the Board is not responsible for nor has the duty to review the actions or omissions of these Local Boards, but does have the discretion to seek review or rehearing (and does so) to protect the System as a whole. Additionally, although not part of the defined benefit plan, the Board also administers a separate cancer insurance program for members of the System.

FUNDING STATUS

As of fiscal year-end, the financial status of the PSPRS, as reflected in its funding ratio, decreased from 57.2% at June 30, 2013, to 50.4% at June 30, 2014. The primary contributor to this decline was the court-ordered reinstatement of the previous mechanism for funding permanent benefit increases (PBI). That mechanism was modified with the passage of SB 1609 in the Fiftieth Legislature, First Regular Session (2011), but was immediately challenged in the courts, along with other key pension reform initiatives, upon enactment. In February 2014, the Arizona Supreme Court affirmed the ruling of the Superior Court in the *Fields* case that changes made to the funding mechanism for PBIs were unconstitutional as applied to already retired members. As such, the liability associated with the reinstatement of the previous PBI mechanism, which included retroactive payments back to 2011, accounted for 6.1% of the overall 6.8% decline.

This PBI mechanism requires that in any year in which the System generates an investment return in excess of 9%, one-half of that excess return be diverted into the PSPRS Reserve for Future Benefit Increases. These Reserve assets finance the PBIs for all eligible beneficiaries. As such, these assets are not used to decrease the System's unfunded liabilities, and the unfunded liabilities continue to rise as additional PBIs are awarded. This creates a scenario in which higher investment returns create additional unfunded liabilities that outpace or outmatch the Fund's ability to accumulate assets necessary to cover these liabilities.

Another factor contributing to the funding level decline is the ongoing recognition of asset losses from fiscal years 2008, 2009 and 2012, which continue to offset any gains enjoyed over the past seven-year smoothing period. This accounted for 2.4% of the overall decline in the funding ratio. Fortunately, 2014, is the last year that the System will have to account for 2008 losses in our seven-year actuarial smoothing methodology. Unfortunately, the one-seventh share of fiscal 2009 losses that will need to be recognized next fiscal year is $184 million, which will, again, most assuredly impact future gains. Conversely, unexpected demographic changes allowed for a positive increase of 1.7% in the overall changes to the funding ratio.

While the numbers above are presented in the aggregate, it is important to remember that any aggregate number calculated for PSPRS is for comparison purposes only and does not necessarily reflect the most accurate picture of the System. Because PSPRS is an agent multiple-employer plan, it is comprised of 237 individual plans whose employers are responsible for their own assets and liabilities. As such, each individual plan has its own funding level.

SUMMARY

I look forward to the challenge of moving the System forward with a program of constructive and comprehensive change that will maintain high quality customer service and restore the PSPRS Plan to a path of improving financial status.

Respectfully submitted,

Jared A. Smout
Deputy Administrator

SUMMARY COMPARATIVE STATEMENTS OF FIDUCIARY NET POSITION

Net Position are the resources available to pay pension benefits in the future. Net position increased $697.36 million in fiscal year 2014.

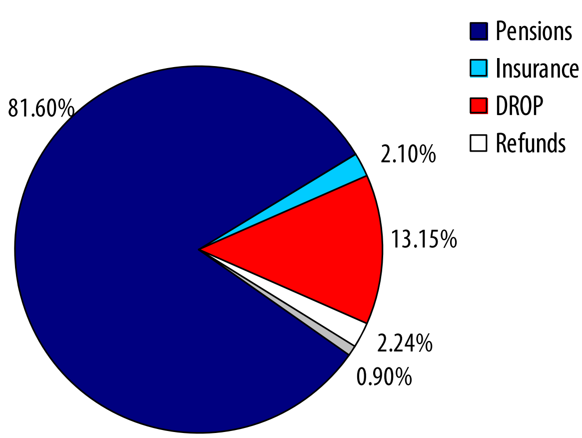
ASSET CATEGORY	YEAR ENDED JUNE 30, 2014	YEAR ENDED JUNE 30, 2013	AMOUNT OF CHANGE	PERCENT CHANGE
Cash and Short-Term Investments	279,346,379	107,493,228	171,853,151	159.87%
Total Receivables	65,784,963	39,828,240	25,956,723	65.17%
Total Investments	5,947,189,662	5,392,261,504	554,928,158	10.29%
Securities Lending Collateral	446,357,582	171,006,687	275,350,895	161.02%
Net Capital Assets	3,487,856	3,643,709	(155,853)	(4.28)%
Total Plan Postion	**6,742,166,442**	**5,714,233,368**	**1,027,933,074**	**17.99%**
Accrued Accounts Payable	47,364,078	352,877	47,011,201	13,322.26%
Investment Purchases Payable	22,023,345	13,816,754	8,206,591	59.40%
Securities Lending Collateral	446,357,582	171,006,687	275,350,895	161.02%
Total Plan Liabilities	**515,745,005**	**185,176,318**	**330,568,687**	**178.52%**
Net Position	**6,226,421,437**	**5,529,057,050**	**697,364,387**	**12.61%**

SUMMARY COMPARATIVE STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION

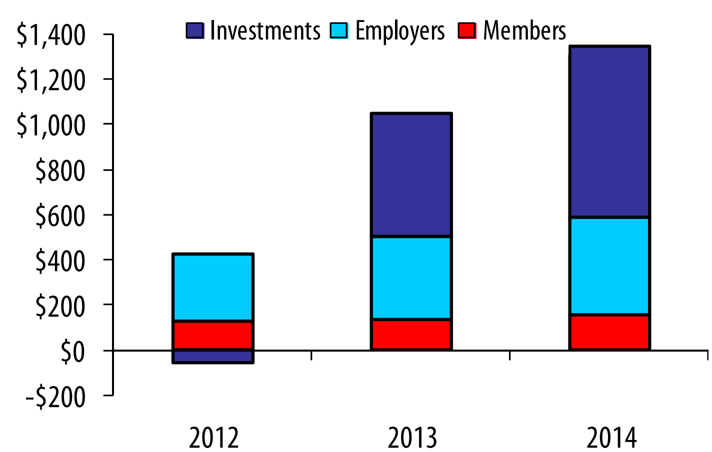
Changes in Net Position summarize the income and expense components of the plan. Net Investment Income increased $215.20 million in fiscal year 2014.

ASSET CATEGORY	YEAR ENDED JUNE 30, 2014	YEAR ENDED JUNE 30, 2013	AMOUNT OF CHANGE	PERCENT CHANGE
Total Contributions	585,402,560	515,046,528	70,356,032	13.66%
Net Investment Income (Loss)	757,180,984	541,980,088	215,200,896	39.71%
Transfers and Service Purchases	775,283	744,656	30,627	4.11%
Total Additions (Reductions)	**1,343,358,827**	**1,057,771,272**	**285,587,555**	**27.00%**
Benefits	625,683,000	566,103,901	59,579,099	10.52%
Service Transfers and Refunds	14,485,192	13,333,922	1,151,270	8.63%
Administrative Expenses	5,826,248	5,104,446	721,802	14.14%
Total Deductions	**645,994,440**	**584,542,269**	**61,452,171**	**10.51%**
Net Increase (Decrease)	697,364,387	473,229,003	224,135,384	47.36%
Beginning of Year Net Position	5,529,057,050	5,055,828,047	473,229,003	9.36%
End of Year Net Position	**6,226,421,437**	**5,529,057,050**	**697,364,387**	**12.61%**

EXPENSES BY TYPE



REVENUES BY SOURCE (in millions)



Ryan Parham
Chief Investment Officer

NOTES FROM THE CHIEF INVESTMENT OFFICER

As the Chief Investment Officer of the Public Safety Personnel Retirement System (PSPRS) during the fiscal year beginning July 1, 2013 and ending June 30, 2014, I submit the following comments and observations for your consideration and for the consideration of the respective parties in interest of the System.

DIVERSIFICATION (HOW MUCH UP AND HOW MUCH DOWN)

The Trust's portfolio returns for the fiscal year ending June 30, 2014 continue to come from many diversified sources (10 separate asset classes.) We expect that diversification to help us to *capture* most of strong positive markets and to *protect* us from the worst of devastating negative markets. This was demonstrated in 2014 where we captured almost 3/4 of the returns of stock heavy portfolios. But in Q3 2014, when stocks were hard hit we had only 1/3 of the losses of those portfolios.

For the past five years the total volatility of the PSPRS portfolio has been roughly one half that of the U.S. Stock markets.

THE PSPRS TEAM (A FURTHER NOTE)

We have been much in the news in the last year as a variety of reckless allegations made by former staff members were investigated, often at our request. I am happy to report that, yet again, PSPRS has been exonerated of any wrong doing, most recently by the U.S. Attorney's office. I can further confirm that all members of the PSPRS investment staff are currently paid below the median and below the average of their peers in similar funds throughout the U.S. as reported in a recent compensation survey.

The current PSPRS Investment team brings together more than 100 years of experience, 7 master level degrees along with 5 doctorate level degrees. When we add that to the hundreds of analysts who work within our consultancies in offices around the world, we have expertise, experience and coverage to manage our truly global and diversified portfolio.

I am wonderfully proud of all the hard work that has been done by Staff and our Consultants which has produced these admirable results.

CONCLUSION

We continue to make significant progress in building a high performing and resilient portfolio. Greater stability achieving our expected return will over time improve the funding ratios of the plan. Accomplishing these goals in extremely turbulent economic environments is difficult but has helped to demonstrate the greater downside protection of the portfolio.

We have created a portfolio that is designed to protect on the downside and capture most of the upside of the markets. It is designed to earn our assumed earnings rate, not in every year, which as you can see from the markets is virtually impossible, but to earn 7.85% on average over longer time frames.

INVESTMENT RETURNS

	1 YEAR	3 YEAR	5 YEAR
PSPRS Trust Total Fund*	13.28%	7.65%	10.68%
*Balanced Index ** *	*13.82%*	*8.84%*	*11.15%*
PSPRS Trust Equity*	21.20%	10.36%	14.72%
*Equity Benchmark *** *	*23.68%*	*11.78%*	*15.82%*
PSPRS Trust Fixed Income*	6.21%	4.62%	6.31%
*Fixed Income Index **** *	*7.39%*	*2.57%*	*4.60%*

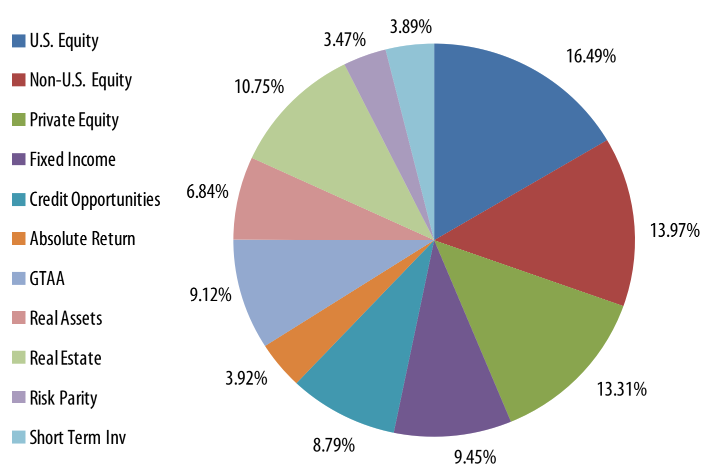
* Time weighted rate of return based on the market rate of return (net of fees).

** Benchmark: 18% Russell 3000, 14% MSCI World Ex-US Net, 9% Russell 3000 + 100 bps, 12% BC Global Aggregate, 12% Credit Opportunities Benchmark, 4% BofA ML 3-Month T-Bill + 200 bps, 8% 3-Month LIBOR + 300 bps, 7% CPI + 200 bps, 10% NCREIF NPI, 4% Risk Parity Benchmark and 2% BofA ML 3-Month T-Bill.

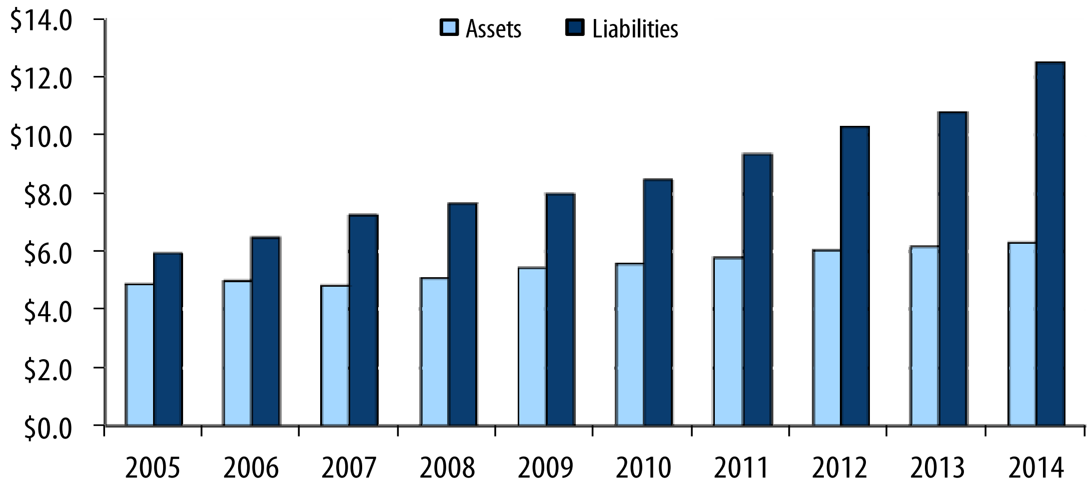
*** Benchmark: 57.14% Russell 3000, and 42.86% MSCI World Ex-US.

**** Benchmark: 100% BC Aggregate.

ASSET ALLOCATION



FUNDING PROGRESS (in millions)



SUMMARY OF EXPERIENCE GAIN (LOSS) (+000)

According to this schedule the Unfunded Actuarial Liability decreased by $210.04 million during fiscal year 2014.

CATEGORY	2014	2013	2012	2011	2010
UAAL Start of Year	4,638,844	$ 4,273,935	$ 3,569,316	$ 2,900,518	$ 2,543,954
Normal Cost	286,676	293,207	278,249	267,461	281,260
Funding Method Contributions	565,868	515,047	437,210	406,045	(413,457)
Interest Accrual	353,191	333,041	287,911	240,654	210,618
Expected UAAL Before Changes	4,712,843	4,385,136	3,698,266	3,002,588	2,622,375
Change From Benefit Increases	1,291,150	-	167,001	154,777	139,653
Change in Actuary Methods	-	74,793	347,081	381,347	-
Change in Future Benefit Increase Reserve	-	-	(182,218)	(130,358)	(34,602)
Expected UAAL After Changes	6,003,993	4,459,929	4,030,130	3,408,354	2,727,426
Actual UAAL	6,214,033	4,638,466	4,273,935	3,569,616	2,900,518
Gain (Loss)	(210,040)	(178,537)	(243,805)	(160,962)	(173,092)

HISTORICAL TRENDS (+000)

As the funding ratio of the plan has declined, the aggregate employer contribution rate has escalated. The employer rate is set in accordance with the results of the annual actuarial valuation. The employee rate is fixed by statute.

VALUATION JUNE 30,	FISCAL YEAR	VALUATION ASSETS	UNFUNDED LIABILITIES	ACCRUED LIABILITIES	FUNDED RATIO	EMPLOYER RATE (AVG)	EMPLOYEE RATE
2005	2007	4,886,963	1,064,974	5,951,937	82.1%	13.83%	7.65%
2006	2008	4,999,911	1,495,101	6,495,012	77.0%	16.52%	7.65%
2007	2009	4,829,521	2,438,770	7,268,291	66.4%	21.71%	7.65%
2008	2010	5,095,645	2,567,134	7,662,779	66.5%	20.77%	7.65%
2009	2011	5,445,497	2,543,954	7,989,451	68.2%	20.89%	7.65%
2010	2012	5,591,304	2,900,518	8,491,822	65.8%	22.68%	8.65%
2011	2013	5,795,945	3,569,316	9,365,261	61.9%	27.18%	9.55%
2012	2014	6,051,595	4,273,935	10,325,530	58.6%	30.44%	10.35%
2013	2015	6,185,074	4,638,466	10,823,540	57.1%	32.54%	11.05%
2014	2016	6,313,415	6,206,116	12,519,531	50.4%	41.37%	11.65%

ACTIVE MEMBER DATA

FISCAL YEAR ENDED	# ACTIVE MEMBERS	PAYROLL +000	AGE (YEARS)	SERVICE (YEARS)	AVG. PAY	INCREASE IN AVG. PAY
2005	16,317	974,863	37.6	9.5	59,745	3.9%
2006	17,324	1,073,685	37.4	9.0	61,977	3.7%
2007	18,624	1,228,037	37.3	8.9	65,938	6.3%
2008	19,912	1,383,332	37.3	8.9	69,472	5.4%
2009	19,867	1,415,643	37.8	9.4	71,256	2.6%
2010	19,468	1,400,547	38.4	10.0	71,941	1.0%
2011	18,638	1,325,350	38.6	10.2	71,110	-1.2%
2012	18,542	1,349,252	39.1	10.6	72,767	2.3%
2013	18,436	1,370,609	39.5	11.1	74,344	2.2%
2014	18,526	1,390,346	39.7	11.2	75,048	0.9%

Active membership increased slightly during fiscal year 2014.

RETIRED MEMBER AND SURVIVOR DATA

FISCAL YEAR ENDED	NORMAL	DISABILITY	SURVIVORS	TOTALS	ANNUAL PENSIONS	AVERAGE PENSION	RATIO OF ACTIVE TO RETIRED
2005	4,733	1,012	943	6,688	244,294,740	36,527	2.5 to 1
2006	4,935	1,061	978	6,874	265,826,712	38,671	2.5 to 1
2007	5,625	1,128	880	7,633	307,657,629	40,306	2.4 to 1
2008	5,986	1,195	1,060	8,241	342,845,751	41,602	2.4 to 1
2009	6,307	1,211	1,091	8,609	379,007,918	44,025	2.3 to 1
2010	6,557	1,252	1,145	8,954	410,594,624	45,856	2.2 to 1
2011	7,015	1,314	1,193	9,522	454,571,881	47,739	2.0 to 1
2012	7,219	1,344	1,239	9,802	485,003,106	49,480	1.9 to 1
2013	7,444	1,305	1,410	10,159	503,588,291	49,571	1.8 to 1
2014	7,689	1,460	1,375	10,524	543,209,329	51,616	1.8 to 1

Does not include DROP.

SUMMARY OF BENEFIT INCREASES

FISCAL YEAR ENDED	EXCESS YIELD PER STATUTE	EXCESS EARNINGS	EARNED ON EXCESS AVAILABLE	UTILIZED TO FUND COLA	EXCESS EARNINGS AVAILABLE	BENEFIT INCREASE 4% CAP
2005	0.11%	2,198,002	51,818,252	(85,121,958)	537,513,325	116.82
2006	0.00%	-	44,613,606	(91,412,190)	490,714,741	121.76
2007	8.05%	190,317,350	83,666,863	(101,767,604)	662,931,350	127.06
2008	0.00%	-	(48,208,368)	(114,771,709)	499,951,273	134.34
2009	0.00%	-	(88,616,363)	(125,721,193)	285,613,717	138.66
2010	4.47%	90,856,517	38,472,168	(139,653,075)	275,289,327	146.74
2011	8.37%	111,327,479	47,817,756	(154,776,639)	279,657,923	152.84
2012	0.00%	-	(2,209,298)	(173,606,421)	103,842,204	159.13
2013	1.64%	23,833,551	11,048,811	(138,724,566)	-	121.19
2014	4.28%	71,624,927	-	(71,624,927)	-	65.20

Benefit increases are dependent upon an available balance in the System's excess earnings reserve.

VISION	MISSION	VALUES
• Invest, secure and manage responsibly the retirement funds of its members in accordance with all legal, investment and financial requirements and in a manner consistent with the quality to which its members have become accustomed.	• To be a low cost, highly personalized quality service provider of funds management and benefit services. • To manage long-term investments with the goal of consistently outperforming over time the composite weighted market return benchmark net of all investment related costs so as to assure the financial integrity of the funds and the security of the benefits these funds provide.	• Do what is best for our members and financial health and integrity of the System. • Be proactive. • Committed to high quality, uniform, sustainable service. • Innovative and cost effective in Plan administration and services. • Use best practices in HR management.

This booklet provides a summary of the data contained in the PSPRS Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2014. The booklet does not contain all the information and schedules necessary to be in conformance with Generally Accepted Accounting Principles (GAAP). However, the CAFR is produced in conformity with GAAP and can be obtained by visiting our website at www.psprs.com.

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