Local Authorities Pension Plan

2018 ANNUAL REPORT

The Local Authorities Pension Plan (LAPP) is a defined benefit pension plan established in 1962 for the employees of local authorities in Alberta. The employers include organizations from the health care sector, cities, towns, villages, municipal districts, colleges, school boards and other public sector organizations.

Effective March 1, 2019 LAPP Corporation became the legal trustee and administrator of the Plan. Prior to that date, and for the period of these financial statements (the year ending December 31, 2018), the President of the Alberta Treasury Board and Minister of Finance was the legal trustee and administrator of the Plan.

During 2018, the Plan was governed by a 14-member Board of Trustees, nominated by employees, employers, retirees and government. As legal trustee, the Minister delegated different functions of the plan as follows:

- **Alberta Local Authorities Pension Plan Corp. (ALAPP Corp.) was responsible for strategic guidance and Board support;**
- **Alberta Investment Management Corporation (AIMCo) was responsible for investment management;**
- **Alberta Pensions Services Corporation (APS) was responsible for benefit administration; and**
- **The Deputy Minister of Alberta Treasury Board and Finance was responsible for LAPP's financial statements.**

Contributions are collected from employers and employees and the money is invested in equities, bonds and other investment vehicles. The investment income and the contributions are used to pay pension benefits to LAPP retirees, now and in the future.

Front page photo:
Marni Panas,
Program Manager,
Diversity & Inclusion,
Alberta Health Services

Photo credits: **Venessa Benson,** Front cover & pages 1,2, 7, 8, 9, 10, 13, 16, 25, 26, 27, 28, 29
Gord Wright, pages 11, 12, 17, 19, 24

Thanks to LAPP Members for allowing their photos to be used for this and other publications.

For more information on LAPP visit www.lapp.ca.

lapp | Local Authorities Pension Plan

Contents

Alberta's largest public sector pension plan

Jerry Gill
Heavy Equipment Technician, City of Edmonton

Highlights

Year at a Glance

- Net assets (what we have after expenses): **$44.5 billion**
- Pension obligations (current and future accrued pension benefits): **$41.0 billion**
- Surplus: **$3.5 billion**
- Funding status: **108% funded,** down from 113% in 2017
- Total membership: **265,813** up from 259,714 in 2017
- Total participating number of employers: **421**

Molly MacDougall
Secretary, Mazankowski Heart Institute, Alberta Health Services

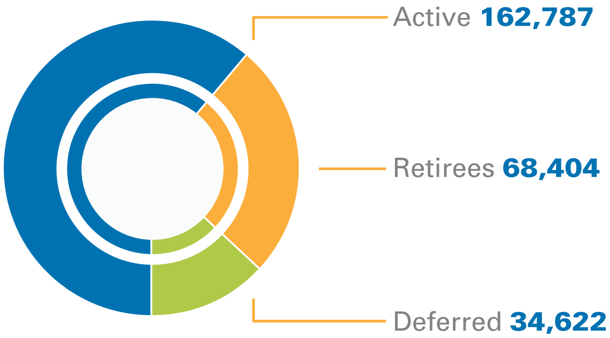
Summary of Financial Position

(As at Dec. 31, 2018)

(thousands)	2018	2017
Net assets available for benefits	$44,468,547	$42,728,515
Pension obligation	$40,999,200	$37,893,000
Surplus/(Deficit)	$3,469,347	$4,835,515

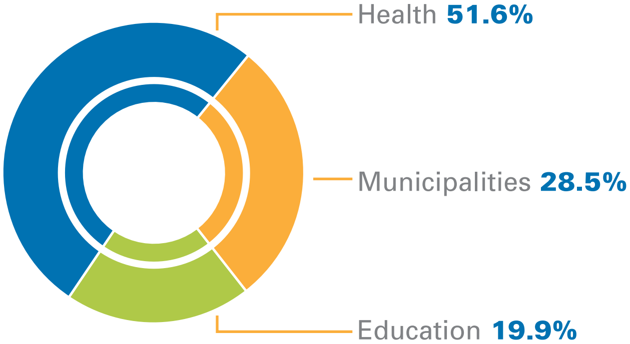
Membership

Dec 31, 2018



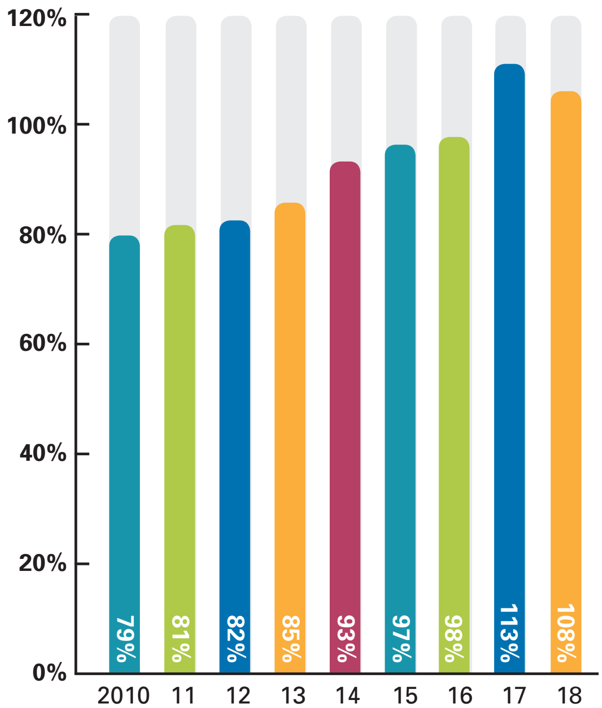
Total: **265,813** members

Membership by Sector



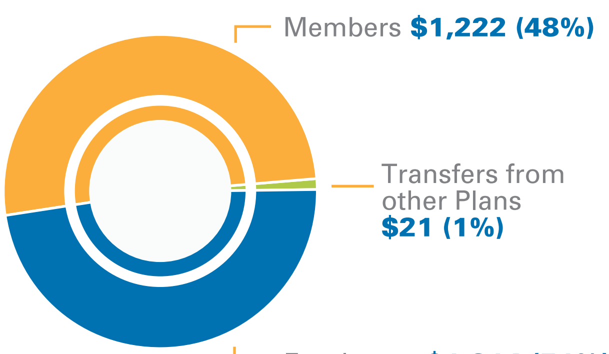
Funding Status

(% funded by year)



Pension Contribution and Transfers

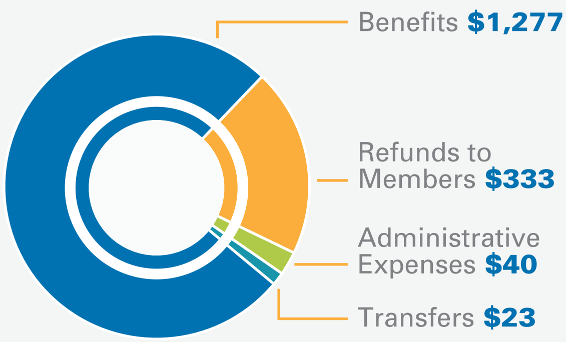
($ millions)



Total: **$2,557** million

Pension Payments

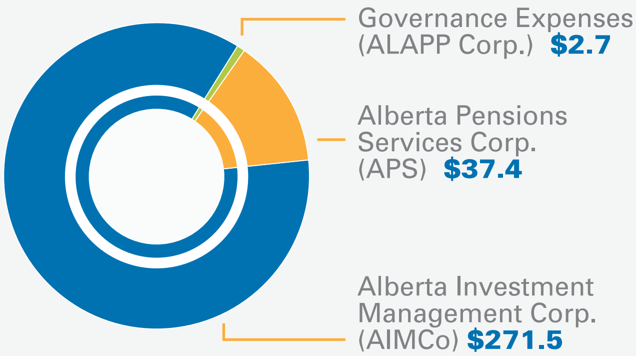
($ millions)



Total: **$1,673** million

Plan Expenses

($ millions)



Total: **$311.6** million

Administration and governance costs: $151 per member, up from $150 per member in 2017

- APS costs to administer pension benefits: $37.4 million
- Governance expenses for overseeing the Plan: $2.7 million
- Actuarial and Audit fees $0.12 million

Investment Costs: per member $1,022 up from $899 in 2017

- AIMCo costs to manage Plan funds, including external managers: $271.5 million

Message from the Chair

Of all of my years on the LAPP Board, I would have to say 2018 was likely the most eventful year to date. It was definitely a year for the LAPP history books.

We started as we always do, working hard for our members and supporting our goal to gain governance changes for LAPP. After decades of doing exactly that, imagine our surprise to come to the end of the year and discover we were finally on the cusp of achieving our elusive goal – LAPP independence from government.

Government began a conversation with stakeholders in the summer of 2018 by sending out a survey on a proposed model for governing LAPP and two other public sector pension plans in Alberta. Stakeholders for our Plan (the sponsors who represent employers and employees of LAPP) put their own model forward and negotiated with government for a few months to ensure that those who were paying for the plan would be appropriately represented at the table when important decisions are made.

In November, government gave third and final reading to Bill 27: *Joint Governance of Public Sector Pension Plans Act*, which would create the LAPP Corporation as official administrator and trustee of the Plan, effective March 1, 2019. The new governance arrangement would mean that all decisions would be made by LAPP's new boards and Alberta's ministers of finance would no longer have final say on matters related to member and retiree benefits.

The Bill passed unanimously and received royal assent December 11. What a great way to end the year!

As welcome as these governance changes are, it gave our small management staff very little time to do a mountain of work to ensure a seamless transition in time for March 1. It meant writing a Plan text, forming a new corporation and setting up two new Boards for LAPP, a Sponsor Board and a Corporation Board, as set out in legislation. It also included negotiating service provider agreements with our investment manager AIMCo (Alberta Investment Management Corporation) and our benefits provider APS (Alberta Pensions Services Corporation).

On behalf of all Board members, I would like to thank our staff for their tireless efforts to get everything done while continuing to operate the pension plan and meet the needs of our members and retirees.

Some LAPP members I meet still ask me why the governance of LAPP is so important and why it is always a subject written about in our newsletters and annual reports. I remind them that in September 2013, then Minister Doug Horner announced plans to unilaterally cut pension benefits to members, going forward. Had the reforms passed, they would have had negative outcomes for current and future members of LAPP.

At the time LAPP was underfunded and still digging out from the global financial collapse of 2008, along with other defined benefit plans in Canada. Although LAPP was steadily paying down its unfunded liability, following a repayment schedule allowed by legislation, the Minister was not prepared to wait for our Plan or others to rebound after the global economic crisis.

Members of LAPP from across the province protested the proposed cuts leading Horner and his government to withdraw the pension legislation, promising a later review. An election held shortly afterward ushered in a new government and Plan stakeholders renewed their lobbying efforts for governance reform.

Since 2013, when that happened, the Plan has gone from 94% funded to 108% funded and assets have grown by $17.6 billion. Just five years later, LAPP has closed 2018 with $44.5 billion in assets and a surplus of $3.5 billion. We have also reduced contribution rates for members and employers for two years running, reducing the cost of the Plan and increasing take-home pay for our members.

2018 was a very good year, indeed. Previous board members of LAPP, serving at any time in the Plan's 57 year history, should take pride in what they have helped to achieve today. On behalf of all the members and retirees of LAPP, thank you Board members and staff for your service.

Terry Agoto
LAPP Board Chair, 2018

Message from the CEO

There is a lot of satisfaction that comes from having a strategic plan that ensures you are **Always a LAPP Ahead!**

When we first developed our punny tagline, it was primarily to help our younger members see the added value that comes with a pension they can calculate in advance, allowing them to start planning early and stay ahead of the game. The truth is, Always a LAPP Ahead! has become the LAPP motto in many ways. It underpins everything we do to make sure pensions stay affordable, stable and secure for everyone, for generations to come.

It applies to our Board, our management team and all the pieces of work we do every day in strategic planning, business planning, risk management, plan funding, plan design, communications, stakeholder relations, investment management, members services, employer services, and the list goes on. The secret of making anything work reliably is to plan ahead, anticipate what might be coming, provide contingencies for what you can't see, and then review it all on a regular basis.

Although we couldn't have known exactly what public equity markets might do in 2018, we could anticipate that the longest bull market in history will not last forever and neither will the double-digit investment returns we have had the last few years. While we couldn't know how many times the Bank of Canada and the U.S. Federal Reserve System would increase interest rates during 2018, we could anticipate that there might be further upward movement from the climb that started in 2017.

While we expected more volatility in the stock market, we didn't anticipate a fourth-quarter plunge that would reduce our annual investment earnings to 2%. Nevertheless, we were prepared for it all anyway by ensuring we are **Always a LAPP Ahead!** As it turns out, it seems that motto is also a key component of our funding and risk strategy.

As a result of our work, and despite reduced revenues, LAPP ended 2018 with a surplus of almost $3.5 billion and a funded ratio of 108%. We did this in a year where we reduced the contribution rates paid by our employers and members by 1% each, passing along some of the gains we have strategically accumulated as we build margin and prepare for what we can't see coming.

Our plan has been working so well in fact, the Board agreed in 2018 to reduce rates for employers and members again in 2019, by another 1% each. This is done knowing that we are far enough ahead that we will not have to start raising rates again if we have another volatile year like the one we just had. Contribution volatility is as important a risk to manage for LAPP as unsettled markets and destabilizing economies.

It's all a careful balancing act to be sure, but it is one we undertake to fulfill our promise of a secure and stable pension for generations of members.

With all of the political ups and down around the world in 2018, it is fair to say that LAPP was somewhat caught up in its own political preoccupations, continuing to focus on our goals related to self-governance and best governance practices. Successfully, our age-old preoccupation has finally paid big dividends to LAPP members and employers, as we finish the year at a new starting line.

An independent LAPP effective March 1, 2019, helps considerably to reduce current and future risks to the Plan. It allows Plan sponsors, to manage the Plan without interference or delay, to secure the pension promise for our members. A lot of passion has gone into achieving this goal, especially on the part of staff, engaged stakeholders and previous Boards of LAPP. Congratulations are due to everyone over the years.

The move to joint-sponsorship came quickly, but we had been planning ahead and were prepared for what was coming. It meant a lot of work by folks in the Alberta government departments of pension policy, finance and justice to get legislation negotiated, written and introduced in November. Bill 27: *Joint Governance of Public Sector Pension Plans Act*, was passed unanimously and supported by MLAs from all political parties. It was proclaimed December 11 and then more work began to have everything in place for March 1, resulting in a smooth transition.

This is an important milestone in LAPP's 57-year history and in 2019, I will be honoured and delighted to be on the next leg of the journey, **Always a LAPP Ahead!**

Christopher Brown
President and CEO, LAPP Corporation
(formerly ALAPP Corp.)

LAPP Board of Trustees

Committee Legend AC Audit Committee BG Board Governance Committee HRC Human Resources and Compensation Committee

Board Discussion and Analysis

Carley Binder
Library Manager, Blackfalds Public Library

Board Discussion and Analysis

A lot goes into running a pension plan, but whatever the Board is working on, whatever decision it is making, the focus continues to be on LAPP members.

The Board is committed to its fiduciary duty, which is to always act in the best interest of Plan members. Every aspect of the operation, from funding and investments to administration and communications is important to LAPP because each facet is an important part of delivering the pension promise.

Cara Blatta
Transit Operator,
Edmonton Transit System, City of Edmonton

For LAPP members, the pension promise means when you retire you will have a pension for life. It will be based on a formula that includes your highest average salary and your years of pensionable service – it is not based on how much you and your employer contribute, or how much money is earned in interest or investments.

Market fluctuations and economic downturns will not change the pension promise. The pension is stable and secure and is backed by a very large investment fund, worth $44.5 billion at the end of 2018. The fund is there to make sure there will be enough money, many decades into the future, to pay out a pension for life for everyone enrolled in the Plan. Today there are 265,000+ members and retirees. To make that kind of promise, you have to be very good at planning ahead and even better at managing risk. As luck would have it, LAPP takes pride in being very good at both these things.

Planning Ahead

Strategic planning is an essential part of all the important work that goes on at LAPP. As set out in the document, *LAPP Strategic Plan: 2017 – 2019*, the Board and management of LAPP focused on: achieving good governance, exceling in enterprise risk management, increasing stakeholder engagement, improving member communications and building a strong and responsive organization. There are five goals in the strategic plan as follows:

1. Stakeholders are directly engaged within LAPP's current governance framework.
2. Joint sponsorship and self-governance of the Plan are achieved.
3. LAPP is an industry leader in enterprise risk management.
4. Appreciation and understanding of LAPP are increased.
5. An effective organization exists to manage the challenges facing LAPP.

All strategic goals are revisited annually and remain the focus of what the Board and management do to secure the member benefit at a reasonable cost, while keeping the Plan sustainable and stakeholders informed. Each goal is discussed in more detail below, with the first two governance goals discussed last.

Risk Management

Managing a pension plan means looking a long way into the future and trying to plan for what lies ahead before one can be certain what's coming. It means aligning long-term strategy with short-term goals and priorities to ensure that steps taken today will put the Plan in a position to meet the needs of tomorrow. It requires a lot of review, analysis and assumption setting and it is an important part of what the Board and management do each year to make sure the Plan is on solid footing and prepared for the challenges ahead.

Risk management is a strategic priority that stands on its own for LAPP but it is also interwoven through all Board strategies. It is at the centre of decision-making and process. It is a lens to view all aspects of what is needed to provide for the long-term sustainability of the Plan and secure the pension promise for LAPP members.

In meeting its fiduciary responsibility to Plan members, the Board is tasked with managing a spectrum of risks facing the Plan and it reports annually on those risks to the President of Treasury Board and Minister of Finance (Minister) using a tool called the Enterprise-Wide Risk Management Framework. Recently updated by management with a more robust risk register and risk dashboard, the document provides a comprehensive assessment of all the risks facing LAPP. It covers the integrated responsibilities of the Board, the Minister and the Plan's two key services providers, AIMCo and APS.

The spectrum of risks to be managed by the Board include, among others:

- Investment risk
- Funding risk
- Contribution volatility
- Longevity risk
- Market/financial risk
- Service provider risk
- Demographic/behavioral risk
- Reputational risk
- Political risk
- Fiduciary risk
- Operational/administrative risk
- Legal/regulatory risk
- Governance risk

While much can be said about any of these risks, individually or combined, it is clear that a prudent plan to manage them is critical for the effective management of a pension plan. It takes considerable planning, forecasting and measurement to respond quickly and appropriately to risk, and in those areas where a quick response is not an option (illiquid investments for example) a strategy must be in place to ensure risks are balanced out elsewhere.

It is the nature of a defined benefit plan that its funded status will fluctuate from year to year as the Plan takes on risk to earn the revenue it needs to fund pensions. This is especially true in an environment of low interest rates that drive up the current cost of future pension obligations. Using riskier assets to produce higher long-term expected returns helps lower the cost of providing pensions in the long term, but then LAPP has to manage the shorter term impact of holding onto those riskier assets.

Chris DeCastro
Street Sweeper Operator, City of Red Deer

Jason Sernecky
Electrician, Electric, Light & Power -City of Red Deer

An important part of LAPP's plan to manage its risk has been the development of a risk appetite statement by the Board and a process for reviewing and renewing it on a regular basis. Setting risk appetite is important to ensure that any actions taken fall within the scope of risk the Board is willing to take.

Taking on risk is a necessary function of pension management and it is essential to see that not all risks are "bad". For example, in a low-interest-rate environment it is necessary for the Board to take on a higher-level of risk with some investments in order to achieve return objectives. What is important, is taking a balanced approach to risk, identifying an appropriate risk appetite and adapting to what comes.

The Board's careful consideration of risk appetite is a key success factor. It is better to know in advance how to respond if the market shifts or the economy takes a turn. Prudent planning based on sound objectives and a long-term outlook are important for a pension plan like LAPP's. All good strategy is based on good risk management.

One of LAPP's strategic goals is to be the industry leader in enterprise risk management **(Goal 5)**. There is no better way to advocate for the success of a sustainable, defined benefit pension plan than to lead the way by being the best. Through a continuous reassessment of risk, based on a sustained program of asset-liability management, LAPP has the ability to explore a number of different funding and investment options. The added bonus is we do this work within the context of being a financially healthy and relatively young pension plan with a steady growth in Plan membership.

Communications and Education

Goal 4 of the Board's strategic plan is to increase the appreciation and understanding of LAPP. While everyone likes to be appreciated, the intent of this goal is not for LAPP to be looking for a pat on the back. The point is to ensure that every member knows how a LAPP pension works, understands why it has value, and appreciates that knowing these things will lead to successful retirement planning.

After many conversations with Plan members and after several surveys and focus group sessions, it has become clear that members do not understand their pension plan as well as they believe. A key finding is that many members still expect they will get their contributions and their employer's contributions back, with interest, when they retire. What they are describing is a defined contribution (DC) plan, not a defined benefit (DB) plan and they need to understand the difference between them to plan adequately for retirement.

A complicating factor is that many people put off retirement planning far longer than they should. By doing so, they might miss opportunities to make the most of their DB pension by buying back service or by transferring it in from elsewhere while it is less costly to do so. Procrastination can also result in missed opportunities for setting aside other retirement savings. Those who work part time or join the Plan later in life, may not retire with the income they need to fund the retirement they want. They may need other savings. The sooner members start planning, the better prepared they will be.

In a recent strategic planning retreat, the Board agreed to take on a broader duty than just securing the pension promise. By helping members to understand their pension and better prepare for retirement, LAPP would be helping members to make the most of their retirement. In support of taking a broader accountability than just paying pensions, the Board adopted the following vision statement:

"A leading pension plan helping members achieve their retirement dreams."

The vision statement is an acknowledgment that not all members have the same retirement dream and that not all retirements will cost the same. The way to help members live their retirement dreams is to educate them on what they can expect from a LAPP pension and help them to plan for the retirement they want, which may include having to find other savings as well.

A lot of has been done in 2018 to increase understanding and appreciation of LAPP for our members and our stakeholders. Communication and

Jane Cherry-Lemire
Arts Director, City of Camrose

education materials have been updated to the new LAPP brand, which explains that retirement planning is more of a marathon than a sprint and introduces members to our pension mentor, Ben E. Fit.

Benny is a marathon runner who is fiscally fit and has been planning for his pension from an early age. He makes complex pension ideas a little easier to understand, while sharing a few laughs along the way. Benny wants to ensure that members are: **"Always a LAPP Ahead."**

More than just a tagline, that motto is the basis for keeping members "on track" for their retirement goals. We provide an award-winning website with tools, estimators and all the information members need to plan a successful retirement. Our goal is to prepare members of all ages and career stages to be successful when they are finally ready to cross the finish line and retire with the income they will need.

Other ways LAPP prepares members for their retirement is through one-on-one sessions, group seminars, webinars and online pension estimators.

LAPP pays for its service provider, Alberta Pensions Services Corporation (APS) to provide these and other services to members and retirees. Help is always available through the member services call centre and now members have access to more self-services and secure email online at mypensionplan.ca.

Our communications and processes are reviewed regularly and members have an opportunity to give feedback through surveys, feedback sessions and in a number of different ways. Our survey results show that our members are pleased with the services they get and they are excited about the communications we provide, especially changes and updates to the LAPP website. Share in the excitement. Go to the LAPP website today. Benny is waiting!

Nelson Gamponia
Labourer, Town of Stettler

Managing Capacity and Change

As LAPP continues to add new Plan members, grow the size of its investments and modernize systems and processes, it becomes necessary to be strategic about responding to goals for improved services and technical processes. Growth means preparing for changes in complexity and capacity and planning ahead for needed resources.

Goal 5 of the strategic plan is, *"An effective organization exists to manage the challenges facing LAPP."* The Plan has changed considerably in complexity since it first began 56 years ago. Today, with more than 265,000 members and an investment fund surpassing $44.4 billion, LAPP is a growing, world-class pension plan that has moved far beyond its simple beginnings.

In addition to ensuring the best possible service for our retirees, members and employers today, it is important to ensure the sustainability of the Plan well into the future. That takes planning, due diligence and hard working professionals who are, knowledgeable, experienced and **Always a LAPP Ahead!**

LAPP has a small management staff of eight people who support the work of the Board and provide strategic oversight for the Plan in the areas of pension policy, funding, investments, risk management, communications, stakeholder relations and pension governance. However, as LAPP grows in size, it continues to grow in sophistication. It is important to continuously assess the needs of the organization as well as the needs of the Plan. It is becoming apparent to the Board that responsibilities are expanding rapidly, especially now that the plan is moving to independence, and it will be necessary to add more professional staff to meet the new challenges posed by the governance changes ahead.

Careful planning is behind all the work at ALAPP Corp. and resources are carefully chosen and strategically aligned with the business goals of the organization. Goals are based on a full understanding of the gaps between where the Plan is today and where it needs to be tomorrow, all of which is contained in a comprehensive work plan that is reviewed on a regular basis. The Board remains focused on ensuring an effective organization exists to manage the challenges ahead.

LAPP Achieves Independence

The road to independence has been a long one for LAPP, with a lot of setbacks along the way. It took more than 25 years of lobbying, on the part of a lot of people, to get the government of Alberta to give up control of the Plan and allow those who sponsor it (employers and Plan members) to make decisions on Plan benefits. At last, government has listened and passed legislation that establishes a new governance structure for LAPP, effective March 1, 2019.

The first two goals of the Board's strategic Plan were related to governance and both were successfully completed in 2018. **Goal 1** was to ensure stakeholders were engaged within the current structure and **Goal 2** was to achieve joint-sponsorship and self-governance. Thankfully the Plan has always had engaged stakeholders who are up-to-date on the issues and challenges facing LAPP. It was their advocacy for governance changes and their availability to negotiate the terms of independence with government that lead to the passing of this new legislation.

On March 1, 2019, the LAPP Corporation will be established as trustee and administrator of the Plan and will be the foundation of a new governance structure that features a bicameral (two-headed) governance system with a representative Sponsor Board and a fiduciary Corporation Board. The Plan will be officially recognized as a jointly-sponsored pension plan (JSPP) with full authority to make all decisions concerning LAPP.

It is an important milestone for LAPP because it means that members are no longer subjected to the political risk and volatility that comes with party platforms and election promises. Members contribute an average 10 per cent of their income every pay period throughout their career to get a pension in retirement. Their employers also contribute, paying one per cent more. It is important that these "cheque-writers" who bear all the risk in the Plan, have the ability to manage those

Sora Kanngiesser
Facility Program Assistant- Collicutt Centre, City of Red Deer

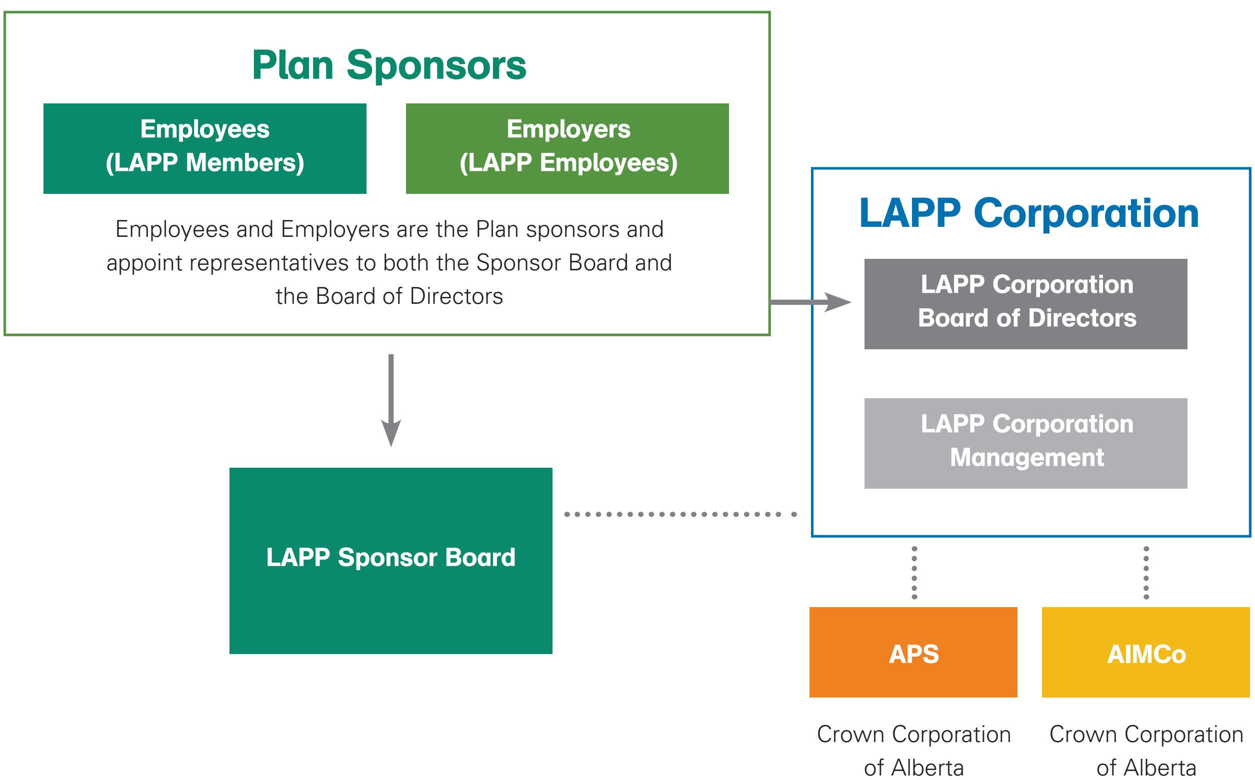
Board Discussion and Analysis

risks without interference and can respond quickly to issues and events when warranted.

The Plan Sponsors will now have their say through representation on a Sponsor Board, which has been given authority in legislation to make decisions on Plan benefits, contribution rates and membership in the Plan. There will also be a Corporate Board to provide direction to the management of LAPP Corporation, which oversees Plan operations, including the administration of pension benefits and investment management of the LAPP fund. The two Boards will work together to see that the Plan is properly funded and the needs of the members and retirees are met. The governance structure of the new LAPP Corporation, effective March 1, 2019, is depicted in the chart below.

The new structure, roles and responsibilities and a list of the official Plan sponsors are set out in new legislation, the *Joint Governance of Public Sector Pension Plans Act*, which became law December 11, 2018. It transfers final decision-making from the Minister to LAPP Corporation and gives LAPP Corporation the authority to properly oversee the administration of the Plan, guide the investment of LAPP's pension fund and provide strategic risk management for all facets of the Plan.

LAPP has 421 employers and dozens of unions and associations representing the 265,000+ members of the Plan. Not all of these sponsors can fit at a decision-making table, so with the input of the major sponsors (LAPP's largest employers and unions), government has named in legislation which organizations will act as the official Plan Sponsors.



The Plan sponsors appoint representatives to both boards, and each board is divided evenly between employer and labour representatives.

The Plan sponsors represent the employers and labour groups in the three sectors of the Plan: health (51% of members), municipalities (29% of members) and education (20% of members). On each Board there are six employer sponsors and six labour sponsors for a total of 12 seats, as follows:

Employers

- Alberta Health Services – 3 seats
- City of Edmonton/ City of Calgary – 1 seat, rotating
- Alberta Urban Municipalities Association/Rural Municipalities Association – 1 seat, rotating
- Alberta School Boards Association/ Council of Post-Secondary Presidents – 1 seat, rotating

Unions & Associations

- Alberta Union of Provincial Employees – 2 seats
- Alberta Federation of Labour – 1 seat
- Canadian Union of Public Employees – 1 seat
- Health Sciences Association of Alberta – 1 seat
- United Nurses of Alberta – 1 seat

For those organizations that share rotating seats, the practice will be that one organization will appoint to the Sponsor Board and the other to the Corporation Board and when the term expires, the organizations will switch which board they appoint to. Under the terms of the legislation, LAPP Corporation is required to use the services of AIMCo and APS for the first five years of self-governance. Both AIMCo and APS continue to be Crown Corporations owned by the Government of Alberta, which work independently, at arms-length, with their own governing boards. The terms of service for each provider will be set out in a written agreement that will be signed by LAPP Corporation and it will be the responsibility of LAPP to ensure that the terms of the agreements are met, both for benefit administration and investment management.

Contribution Rates and Plan Funding

Despite a lower return on investments than expected in 2018, LAPP ended the year in a surplus position, as it did in 2017. While fully-funded status helps provide reassurance that the plan for funding is working, the Board must be prudent and hold on to some of its gains, even while gradually adjusting contribution rates down a little.

Rates were reduced by 1% for employers and 1% for members in 2018. For a LAPP member earning $60,000 a year, this resulted in increasing take home pay by about $600 before taxes. Then again, in the fall of 2018, when the Board conducted a new actuarial valuation, it approved another rate reduction of a further 1% for 2019.

	Contribution Rates for 2018	Contribution Rates for 2019
Member rate up to the YMPE*	**9.39%** on annualized salary* up to $55,900	**8.39%** on annualized salary* up to $57,400
Member rate over the YMPE	**13.84%** on annualized salary over $55,900	**12.84%** on annualized salary over $57,400
Employer rate up to the YMPE	**10.39%** on annualized salary up to $55,900	**9.39%** on annualized salary up to $57,400
Employer rate over the YMPE	**14.84%** on annualized salary over $55,900	**13.84%** on annualized salary over $57,400

* If you work part time, contributions are determined based on your annualized salary. The contribution rate percentages are applied to your annualized salary, and the annualized contributions are then adjusted based on your full-time equivalency (FTE) to determine the required contributions.
The annualized salary is the amount you would have earned if you worked full-time over the same period. It can be calculated by dividing your annual part-time earnings by your FTE.

Contribution rate volatility is one of the risks the Board must manage when it is funding the Plan because there is little value in lowering the rates in one year to raise them again the next year. This means, it is important not to reduce rates for members and employers unless it seems clear the rate reduction can be sustained over time. When rate reductions are made by LAPP they can be counted on as being good news for two reasons; members are getting the same great pension for less money and the plan is well-enough funded to ensure there is a stable, secure cushion supporting the secure benefit members will get in retirement.

The Board makes sure of adequate funding by conducting an actuarial valuation every year and providing for future risks the Plan might face, in addition to known pension obligations. It does this by steadily and prudently expanding its capacity for dealing with future risks, like market volatility or a sudden downturn in the economy. The Board strategically builds margin with the ability to spend it when times are tough or release it when times are good.

Investment Performance

Much of 2018 was characterized by significant market volatility as investors world-over responded throughout the year to tumbling oil prices, economic destabilization and global trade wars. Previous gifts of double-digit returns from a very long-run bull market fizzled out quickly in 2018 and LAPP ended the year with a final 2% return on investments, after an especially negative fourth quarter experience.

However, despite lower-than-expected returns, LAPP still ended 2018 at 108% funded, with an accounting surplus of $3.5 billion. It is the second consecutive year that LAPP has exceeded full funding (113% funded in 2017) and the success comes from a well-balanced and diversified investment portfolio that weathered the volatility and grew the Plan's assets another $1.68 billion over the course of the year.

LAPP's $44.5 billion in assets is invested by AIMCo based on the risk appetite set by the Board and a Statement of Investment Policy and Goals (SIP&G) that identifies the assets mix and weights that reflect that level of risk. AIMCo manages the majority of the Plan's

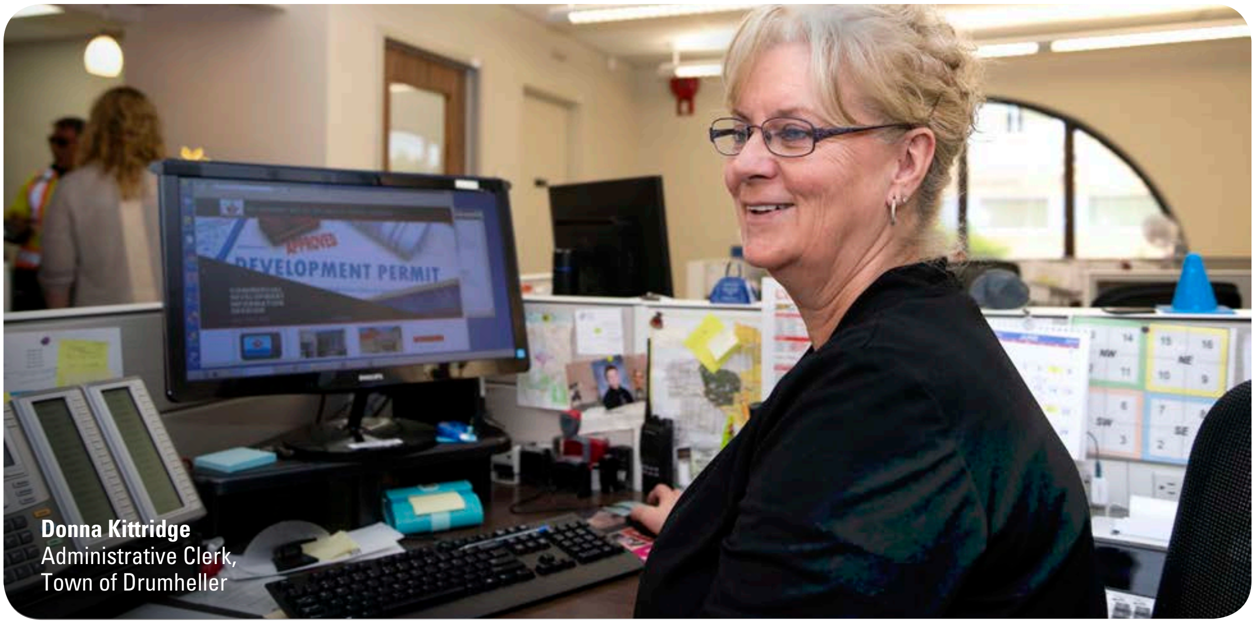
108 Years

FUN FACT

Age of the oldest LAPP retiree

(at the end of 2018, excluding survivors/beneficiaries)

George Duncan
Arena Operator, Collicutt Centre - City of Red Deer



investments internally through pooled investment funds. However, for reasons such as greater diversification, access to external expertise and in order to reduce operational complexity, AIMCo uses external managers for some investments.

To evaluate performance and measure the value returned by AIMCo's active investment decisions, the Board compares the actual investment results to its investment policy benchmark. The benchmark return represents what the Plan could reasonably expect to earn without active management if it invested in the market indices in proportion to the policy asset mix approved by the Board.

AIMCo strives to earn more than market returns by over or underweighting specific investments in relation to the indices. AIMCo is expected to deliver a return of 85 basis points or 0.85% per annum, net of fees, in excess of the policy benchmark over a four-year time horizon.

The table below compares the market-based policy benchmark return to the Plan's actual return. In 2018, AIMCo added value of 1.0% from the market-based policy benchmark of 1.0%. Over a four-year period, the value return from AIMCo was 0.8% per annum compared to the expected value return of 0.85% per annum. Over the longer terms of ten and twenty years, the value return by the investment manager was 0.3% and 0.2% respectively.

Year ending December 31, 2018	Annual Returns (%)				Annualized Returns (%)		
	2018	2017	2016	2015	4 Years	10 Years	20 Years
Market return (Policy benchmark)	1.0	9.0	6.0	6.7	5.6	8.3	6.4
Value added (subtracted) by investment manager	1.0	1.1	(0.2)	1.2	0.8	0.3	0.2
Total Fund Return	**2.0**	**10.1**	**5.8**	**7.9**	**6.4**	**8.6**	**6.6**

Board Discussion and Analysis

Stakeholder Relations

LAPP is very fortunate to have so many key stakeholders who care about LAPP and its members. With 440 employers and dozens of unions and associations across the province, representing the interests of LAPP's 265,000+ members, there are a lot of people and organizations important to LAPP's Board and management. Contact with these stakeholders and continuous relationship building is a valuable preoccupation throughout the year.

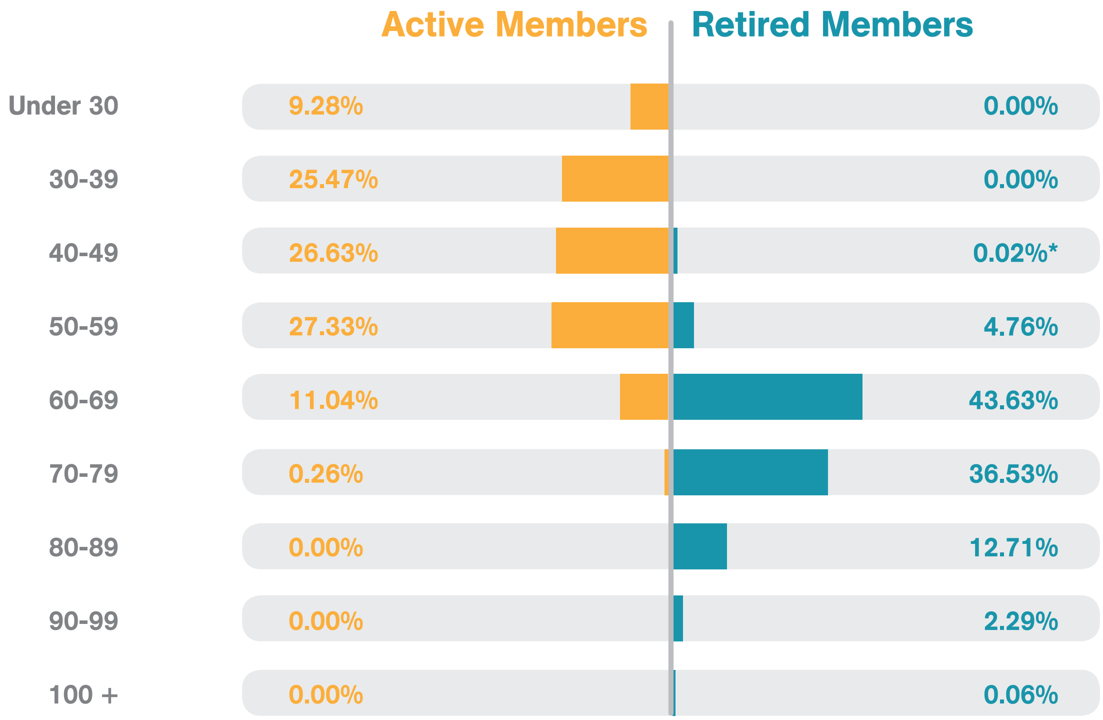
Aside from regular interactions with stakeholders, the Board sets aside two days a year to meet with its Stakeholder Consultation Group (known as the SCG). These stakeholders, totaling about 60 people, come together every spring and fall in Edmonton to learn about how the Plan is doing, what issues and challenges lie ahead, and the Board's strategies for dealing with them.

These employer and labour representatives discuss ideas and concerns in breakout sessions and share best practices in pension administration and finance within and across sectors. It is a great networking opportunity for these individuals, but the greatest value goes to the Board and management, who get to learn first-hand how the LAPP experience is for our members and employers. LAPP is grateful to these organizations for sharing the time and expertise of these knowledgeable and committed individuals.

In 2018, a lot of discussion focused on the issues and decisions needed if the government were to proceed with independence and joint-governance for LAPP. Different governance models were explored, best practices were shared, and the stakeholders were well prepared for a discussion of self-governance when the government was ready to discuss its proposed model and hear from stakeholders about what they wanted. In fact, the Board hosted an extra meeting of the SCG in the summer of 2018 so that these discussions with government could take place.

LAPP stakeholders will continue to be an important part of the work that will be undertaken by the new Sponsor Board in 2019. They will be included in details about the transition and may be asked to provide input and feedback if the Board is faced with decisions related to Plan benefits, Plan membership or other areas of the Board's mandate.

LAPP Member Demographic



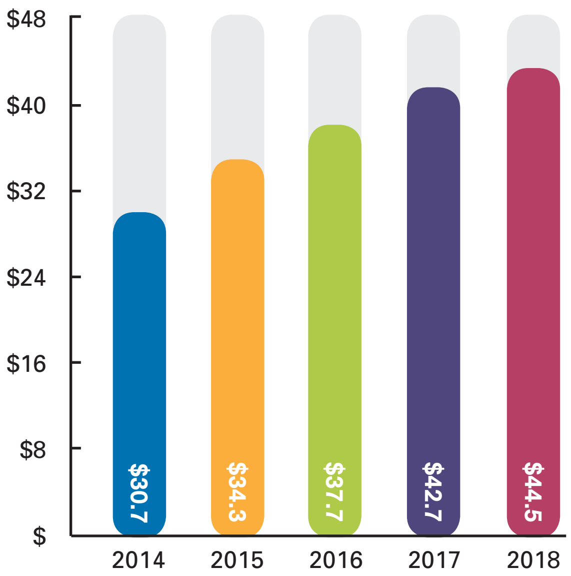
* Disability pensions

Investment Summary

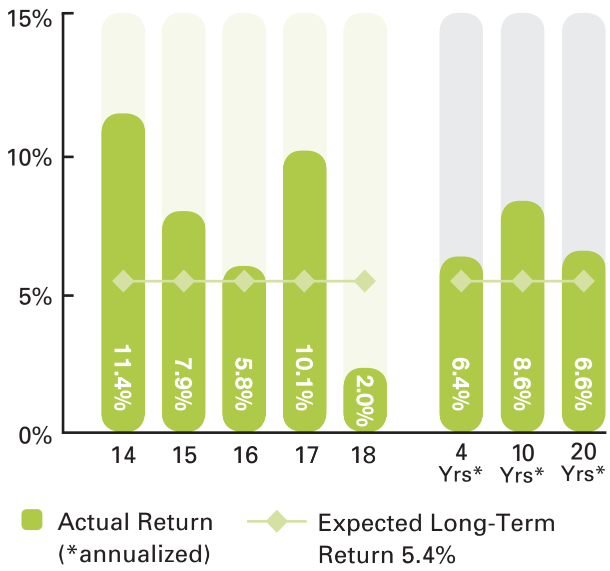
Jeff Knopf
Life Safety Educator, City of Camrose

Investment Summary

Market Value - Investments
(in billions)



Actual Returns by Year (%)



INVESTMENT PERFORMANCE

Investment Management Structure

Alberta Investment Management Corporation (AIMCo), a Crown corporation formed on January 1, 2008, provides the day-to-day investment services for LAPP's investment portfolio. AIMCo invests LAPP's assets for the benefit of its members, in accordance with the LAPP Board's Statement of Investment Policy and Goals (SIP&G). AIMCo manages the majority of the Plan's investments internally through pooled investment funds. However, for reasons such as greater diversification and to reduce operational complexity, AIMCo also uses external managers.

Investments: **$44.5** billion

Return on investments: **2.0**%

Investment income: **$1.0** billion

Investment expenses: **$271.5** million

Market Review

The longest bull run of public equity markets appeared to be losing steam in the early part of 2018, and LAPP earned 0.8% on its investments in the 1st quarter. The US Federal Reserve System and the Bank of Canada continued to increase interest rates, with the US target rate increasing by 100 basis points, or 1%, by the end of 2018.

Equity markets reversed their 1st quarter losses by the end of the 3rd quarter on stronger than expected corporate earnings. LAPP earned 2nd and 3rd quarter returns of 1.8% and 0.2%, respectively. Volatility was the key phrase, as trade war fears and plunging oil prices pushed markets into negative territory by the end of 2018. In the 4th quarter, LAPP lost 0.9% on its investments and finished with a year-to-date return to 2.0%.

Table of Investment Returns

December 31, 2018

Asset/Sub-asset category *Benchmark*	Fair value (in millions)	Asset Mix (%)	Annual Returns % 2018	2017	2016	2015	Compound Annualized Return 4 yr
Fund	**$44,438.2**	**100.0**	**2.0**	**10.1**	**5.8**	**7.9**	**6.4**
Policy			*1.0*	*9.0*	*6.0*	*6.7*	*5.6*
CPI			1.7	2.1	1.2	1.4	1.6
Fixed Income	**14,855.2**	**33.5**	**1.8**	**5.0**	**2.6**	**4.3**	**3.4**
Fixed Income Index			*1.0*	*4.3*	*1.5*	*4.1*	*2.7*
Short Term and Cash	378.0	0.9	1.6	1.0	0.9	0.9	1.1
FTSE TMX 91-Day T-Bill Index			*1.4*	*0.6*	*0.5*	*0.6*	*0.8*
Universe Bonds	5,780.85	13.0	4.7	3.3	3.3	4.1	3.2
Private Mortgages	1,647.2	3.7	4.0	2.5	1.9	5.1	3.5
Private Debt and Loan	708.9	1.6	4.0	2.3	4.4	6.1	4.2
FTSE TMX Universe Bond Index			*1.4*	*2.5*	*1.7*	*3.5*	*2.3*
Long Bonds	6,340.6	14.3	0.9	7.6	2.4	4.1	3.7
FTSE TMX Long-term Government Bond Index			0.5	6.5	1.3	4.5	3.2
Inflation Sensitive and Alternatives	**11,351.8**	**25.5**	**12.9**	**8.1**	**5.2**	**10.6**	**8.6**
Inflation sensitive and Alternative Index			*8.1*	*5.7*	*5.2*	*7.8*	*6.4*
Real Return Bonds	-	0.0	n/a	1.3	3.4	3.0	n/a
FTSE TMX Real Return Bond Index			*n/a*	*0.7*	*2.9*	*2.8*	*n/a*
Real Estate	6,619.9	14.9	12.4	9.1	4.3	10.3	8.6
Combined Real Estate benchmark			*9.5*	*7.0*	*5.8*	*8.0*	*7.6*
Infrastructure	3,954.8	8.9	13.8	7.9	7.8	19.9	10.8
CPI + 4.5% (5 year rolling average)			*6.2*	*6.0*	*5.7*	*5.8*	*5.9*
Timberland	777.1	1.7	12.4	15.7	10.0	7.6	10.5
CPI + 4.5% (5 year rolling average)			*6.2*	*6.0*	*5.7*	*10.0*	*7.0*
Short Horizon	**16,721.8**	**37.6**	**(4.8)**	**15.9**	**9.3**	**11.2**	**7.6**
Short Horizon Index			*(3.6)*	*14.7*	*9.6*	*8.2*	*7.0*
Canadian Equity	3,354.1	7.5	(9.7)	10.0	19.8	(7.4)	2.4
S&P/TSX Capped Composite Index			*(8.9)*	*9.1*	*21.1*	*(8.3)*	*2.5*
Global Equity	8,960.1	20.2	(1.7)	16.2	4.8	21.8	9.9
MSCI World Index			*(0.5)*	*14.4*	*3.8*	*18.9*	*8.9*
Emerging Markets	2,424.6	5.4	(8.2)	30.4	8.7	6.2	8.4
MSCI Emerging Markets Index			*(6.9)*	*28.3*	*7.3*	*2.0*	*6.9*
Small Cap Equity	1,983.0	4.5	(7.2)	14.1	12.1	13.6	7.8
MSCI World Small Cap Index			*(6.1)*	*15.0*	*18.5*	*7.7*	*8.3*
Long Horizon - Private Equity	**1,246.6**	**2.8**	**11.7**	**0.7**	**(2.2)**	**(9.4)**	**4.0**
CPI + 6.5% (5 year rolling average)			*8.2*	*8.0*	*7.7*	*4.8*	*7.2*
Strategic Opportunities, Tactical Allocations and Currency Hedges	**262.8**	**0.6**	**4.6**	**8.3**	**n/a**	**n/a**	**15.1**
Strategic Opportunities	239.4	0.5	(2.2)	5.0	(3.2)	42.8	9.2
Tactical Asset Allocations	19.5	0.1	60.6	38.7	13.1	49.7	39.4
Currency Hedges	3.9	0.0	n/a	n/a	n/a	n/a	n/a

LAPP Investment Summary

Asset Mix

LAPP's Board sets the asset mix policy for the Plan which includes fixed income securities, equities (short and long horizon) and inflation sensitive/alternative investments. The table below compares the target policy asset mix benchmark and minimum and maximum ranges, effective for 2018, with the actual asset mix at December 31, 2018 and 2017.

Asset Mix

December 31, 2018
(in percent)

	Policy Weight	Policy Minimum	Policy Maximum	Actual 2018	Actual 2017
Fixed Income	**30.5**	**20.0**	**40.0**	**33.4**	**32.6**
Short-Term and cash		0.0	10.0	0.9	0.6
Long-Term					
Long-term Bonds		5.0	25.0	14.2	14.5
Universe Bonds		5.0	25.0	13.0	13.6
Mortgages		0.0	10.0	3.7	3.2
Private Debt		0.0	6.0	1.6	0.7
Short-Horizon	**31.5**	**25.0**	**50.0**	**37.7**	**42.5**
Canadian Equity		5.0	20.0	7.5	8.6
Global Developed Equity		10.0	40.0	20.2	23.2
Emerging Market Equity		0.0	10.0	5.5	5.7
Small Cap Equity		0.0	10.0	4.5	5.0
Long Horizon - Private Equity	**6.0**	**3.0**	**9.0**	**2.8**	**2.5**
Inflation Sensitive/Alternatives	**32.0**	**20.0**	**50.0**	**25.5**	**21.7**
Real Estate		10.0	25.0	14.9	12.0
Real Return Bonds *		0.0	10.0	0.0	1.3
Infrastructure		5.0	25.0	8.9	7.2
Timberland		0.0	3.0	1.7	1.2
Strategic Opportunties, Tactical Allocations and Currency Hedges	**-**	**-**	**-**	**0.6**	**0.7**
Total	**100.0**			**100.0**	**100.0**

* Position was sold in March 2018

Risk Management

The LAPP Board accepts that in order to meet the return objectives of the Plan, it must take on risk in the assets in which the Plan invests. The Plan invests in a diverse set of asset types to help improve the likelihood of achieving the desired results for a given level of risk. Investment risk management is a central focus for AIMCo as it seeks to measure and monitor both historic and possible future risks, allocating risk as a scarce resource to the most promising investment opportunities. AIMCo maintains a quantitative investment risk system designed to operate across all asset classes and a variety of risk types such as market risk, currency risk, and concentration risk.

As the ultimate risk to a pension plan is not being able to meet pension obligations, the Board monitors the risk of the Plan's liabilities in relation to the investment assets. The Board has established a series of limits on risk to the Plan's funded status and its investment policies are measured and monitored on this basis.

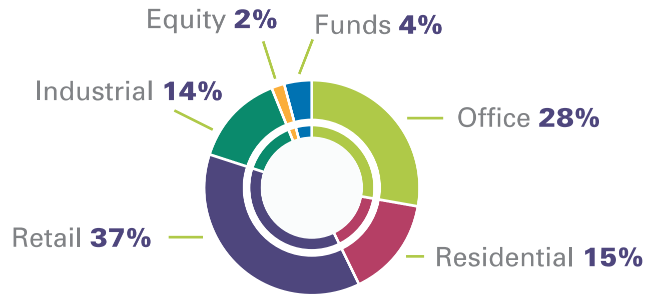
Real Estate

At December 31, 2018, real estate investments comprised 14.9% of the Plan's total investments or $6.6 billion compared to 12.0% or $5.1 billion the previous year. Real estate investments provide diversification, high cash flow and are expected to provide protection from inflation. Canadian real estate exposure is from AIMCo's Private Real Estate Pool which includes a mix of office, retail, industrial and residential properties located in Ontario, Alberta, Quebec and British Columbia.

The Plan also invests in AIMCo's Foreign Real Estate Pool, which includes office, industrial, residential and retail properties in the United States, United Kingdom, Europe and Mexico.

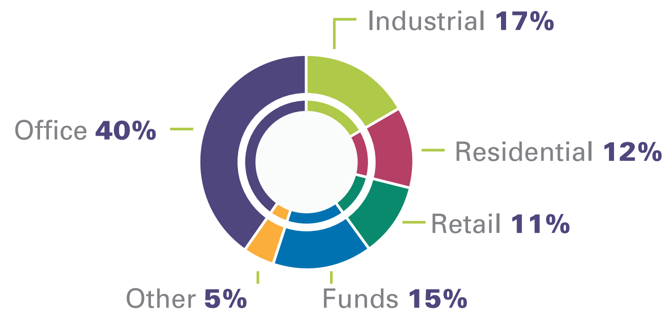
In 2018, the Plan's actual gain from real estate investments was 12.4%, 2.9% more than the combined benchmark gain of 9.5%.

Canadian Real Estate by Sector

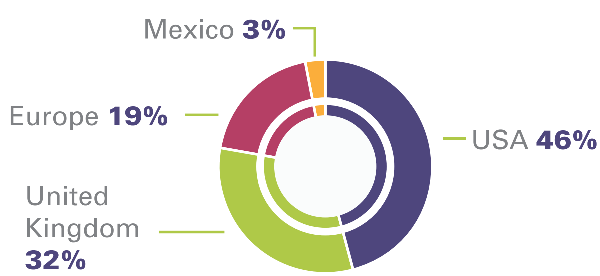


Canadian Real Estate by Province

Foreign Real Estate by Sector



Foreign Real Estate by Geographic Location



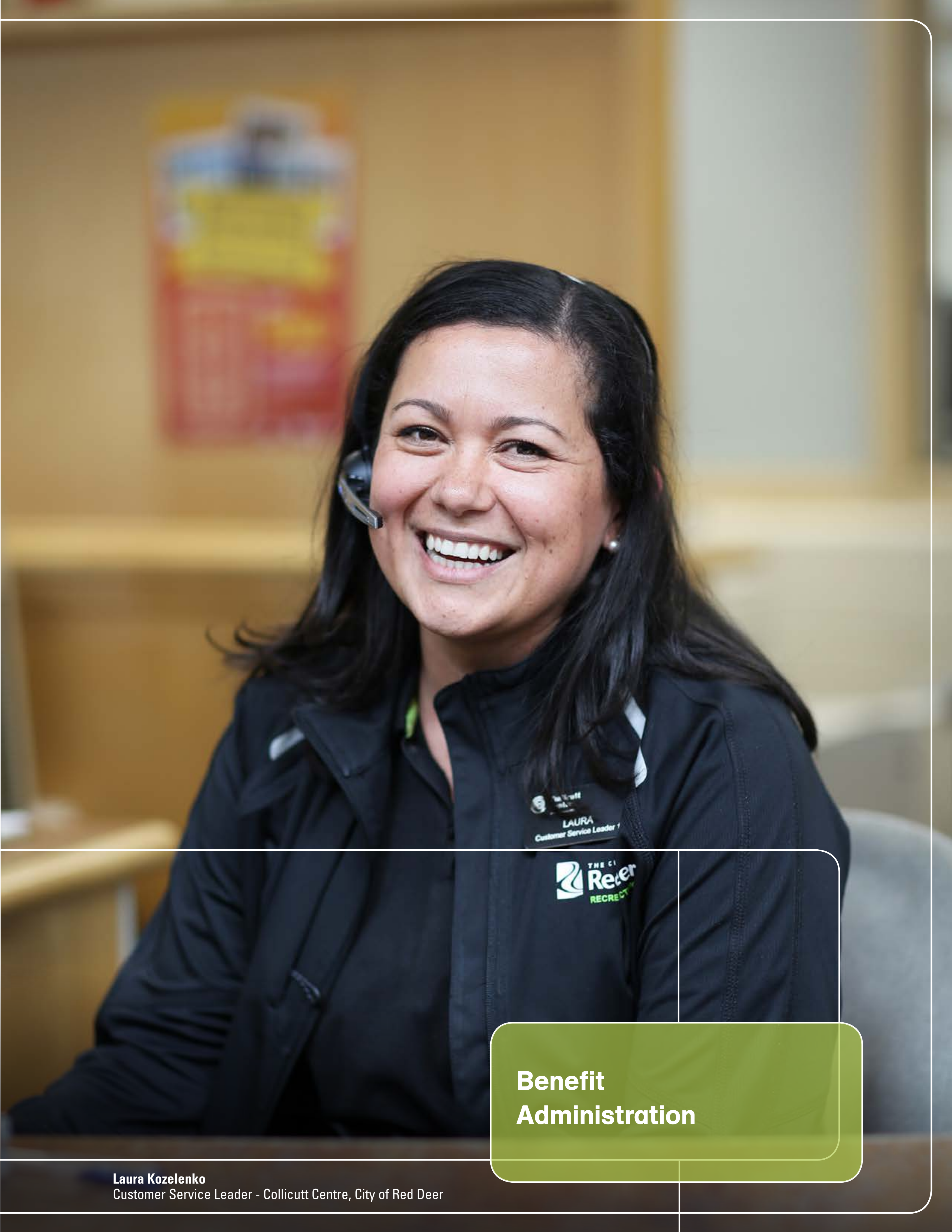
Infrastructure

At December 31, 2018, the Plan's investment in AIMCo's Infrastructure pools comprised 8.9% of total Plan investments or $4.0 billion, up from 7.2% or $3.1 billion held at the end of the previous year. The investment in infrastructure includes projects that provide attractive returns and include projects in transportation (e.g. toll roads, airports, ports and rails), power (eg. contracted power generation and power transmission pipelines) and utilities (e.g. water, waste water and natural gas networks). In 2018, investments in infrastructure gained 13.8%, 7.6% better than the benchmark gain of 6.2%.

Timberland

At December 31, 2018, the Plan's investment in AIMCo's Timberland pools comprised 1.7% of total Plan investments or $777 million, up from 1.2% or $504 million at the end of the previous year. Investments include funds holding timber and forestry property as well as agricultural and farm land in Canada, United States, Australia, New Zealand and Latin America. In 2018, the Timberland investments gained 12.4%, doubling the benchmark gain of 6.2%.

Lana Bosch
Administrative Assistant,
Town of Drumheller



Benefit Administration

Laura Kozelenko
Customer Service Leader - Collicutt Centre, City of Red Deer

Benefit Administration

Darren Thompson
Electrician & Power Engineer,
City of Red Deer Water Treatment Plant

Administration of LAPP Benefits

Alberta Pensions Services Corporation (APS) provided pension services (as directed under a Pension Services Agreement with the President of Treasury Board and Minister of Finance) on behalf of Local Authorities Pension Plan (LAPP).

Services in 2018 included:

- Contributions management
- Member, pensioner and employer information management
- Member, pensioner and employer education
- Benefit calculations
- Benefit disbursements
- Policy development and implementation

LAPP Member Services Expenses

LAPP's share of APS' operating and plan-specific costs are based on cost allocation policies approved by the President of Treasury Board and Minister of Finance. Alberta Local Authorities Pension Plan Corporation (ALAPP Corp.) costs include remuneration to senior officials, a small staff and the Board members.

LAPP's share of APS' costs were $37 million in 2018. Based on average membership, LAPP's per member service expense is $151 which includes APS' operating costs, ALAPP Corp. operating costs and other professional fees.

Member Service Expenses

($ thousands)	**2018**	2017
Alberta Pensions Services Corporation (APS)	37,370	36,482
Alberta Local Authorities Pension Plan Corporation (ALAPP Corp.)	2,704	2,350
Actuarial Fees	123	218
Total member service expenses	40,197	39,050
Member service expenses per member	$151	$ 150

LAPP Members, Pensioners and Employers

Based on year-end totals, LAPP has 421 employers and a total of 265,813 active and deferred members and pensioners. In 2018, 12,776 new members joined the Plan, 3,497 re-joined the Plan, 5,048 members retired, 8,366 members deferred funds, and 6,775 members terminated and left the Plan.

Cost-of-Living Adjustment (COLA) to Pensions in Pay

After a member begins receiving a pension, a cost-of-living adjustment is applied every year there is an increase in the Alberta Consumer Price Index (ACPI). COLA is equal to 60 per cent of the yearly increase of the ACPI.

As of January 1, 2018, the COLA granted to pensioners was 0.78 per cent. For those who retired during 2018, this COLA was prorated.

Activities in 2018

APS achieved the following successes for LAPP, their employers and their Plan members:

- Launched APS Dash—an at-a-glance view of key performance indicators—and made the data available to LAPP management in near real-time. APS Dash allows for more transparency and collaboration between APS and LAPP Corporation.
- Achieved a 99.7% payout calculation accuracy rate for the year.
- APS increased operational efficiency by implementing technology for processing annual member and pensioner statements. The result was a reduction in manual effort by up to 90%.
- Achieved all member phone-call related service level targets, and achieved an 80% satisfaction rating by Plan members.

Ravinder Gill
Plant Operator, City of Red Deer Water Treatment Plant

Benefit Administration

- Provided member education services across Alberta, including 1,097 one-on-one sessions, 222 group sessions and 31 webinars.
- Ended the year with a 78% employer engagement score. The score is comprised of the following measurements of APS' employer services: employer satisfaction, employer compliance and employer portal.
- There were 28,591 new registrations in 2018, with a total of 91,439 members registered.
- Assisted in the enhancement of member resources, such as education session materials, the LAPP Member Handbook and LAPP At-a-Glance.
- Continued to work with LAPP Corporation to add features to the LAPP website.

Looking Ahead:

The following are APS' key areas of focus for 2019:

- Following joint governance, ensuring that all benefit administration activities are compliant with the *Employment Pensions Plan Act* (EPPA) within established timelines.
- Working with key stakeholders and vendors to improve performance of the employer portal, for the purpose of delivering a better user experience for employers.
- Proactively engaging with employers, including the implementation of quarterly, sector-specific employer forums.
- Implementing a plan to ensure that Plan member statements are delivered within the timelines required by the EPPA in 2020.

Joe Croken
Senior Peace Officer, Town of Blackfalds

Contents

Financial Statements

Year Ended December 31, 2018

Amy Boult
9-1-1 Emergency Dispatcher, City of Red Deer Emergency Services

Independent Auditor's Report

To the LAPP Corporation Board of Directors

Auditor General
OF ALBERTA

Report on the Financial Statements

Opinion
I have audited the financial statements of the Local Authorities Pension Plan, which comprise the statement of financial position as at December 31, 2018, and the statements of changes in net assets available for benefits and changes in pension obligations for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In my opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Local Authorities Pension Plan as at December 31, 2018, and the changes in net assets available for benefits and changes in its pension obligations for the year then ended in accordance with Canadian accounting standards for pension plans.

Basis for opinion
I conducted my audit in accordance with Canadian generally accepted auditing standards. My responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of my report. I am independent of the Local Authorities Pension Plan, in accordance with the ethical requirements that are relevant to my audit of the financial statements in Canada, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Other information
Management is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the financial statements and my auditor's report thereon. The *LAPP 2018 Annual Report* is expected to be made available to me after the date of this auditor's report.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

If based on the work I have performed on the other information obtained prior to the date of the auditor's report, I conclude that there is a material misstatement of this other information, I am required to report the fact. I have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements
Management is responsible for the preparation and fair presentation of the financial statements in accordance with Canadian accounting standards for pension plans, and for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Local Authorities Pension Plan's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless it is intended to cease operations, or there is no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Local Authorities Pension Plan financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements
My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Local Authorities Pension Plan's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Local Authorities Pension Plan's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Local Authorities Pension Plan to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

[Original signed by W. Doug Wylie FCPA, FCMA, ICD.D]
Auditor General

April 25, 2019
Edmonton, Alberta

Statement of Financial Position

As at December 31, 2018

	($ thousands)	
	2018	**2017**
Net assets available for benefits		
Assets		
Investments (Note 3)	$ 44,438,154	$ 42,719,090
Contributions receivable		
Employers	14,761	33,159
Employees	13,016	31,069
Accounts receivable	31,342	35,274
Total Assets	44,497,273	42,818,592
Liabilities		
Accounts payable	28,726	75,077
Liability for investment purchases and expenses	-	15,000
Total Liabilities	28,726	90,077
Net assets available for benefits	$ 44,468,547	$ 42,728,515
Pension obligation and surplus or deficit		
Pension obligation (Note 5)	$ 40,999,200	$ 37,893,000
Surplus (Deficit) (Note 6)	3,469,347	4,835,515
Pension obligation and surplus or deficit	$ 44,468,547	$ 42,728,515

The accompanying notes are part of these financial statements.

Statement of Changes in Net Assets Available for Benefits

Year ended December 31, 2018

	($ thousands) 2018	2017
Increase in assets		
Contributions (Note 7)	$ 2,536,483	$ 2,654,790
Investment income (Note 8)	1,126,327	4,124,529
Transfers from other plans	21,361	9,178
	3,684,171	6,788,497
Decrease in assets		
Benefit payments (Note 10)	1,609,864	1,502,853
Transfers to other plans	22,530	7,635
Investment expenses (Note 11)	271,548	233,387
Administrative expenses (Note 12)	40,197	39,050
	1,944,139	1,782,925
Increase in net assets	1,740,032	5,005,572
Net assets available for benefits at beginning of year	42,728,515	37,722,943
Net assets available for benefits at end of year	$ 44,468,547	$ 42,728,515

The accompanying notes are part of these financial statements.

Statement of Changes in Pension Obligation

Year ended December 31, 2018

	2018 ($ thousands)	2017 ($ thousands)
Increase in pension obligation		
Interest accrued on opening pension obligation	$ 2,325,700	$ 2,160,000
Benefits earned	1,736,400	1,825,200
Net transfers	-	1,500
Net increase due to actuarial assumption changes (Note 5a)	1,417,200	-
	5,479,300	3,986,700
Decrease in pension obligation		
Net decrease due to actuarial assumption changes (Note 5a)	-	2,831,200
Net experience gains (Note 5b)	713,700	78,700
Benefits, transfers and interest	1,659,400	1,544,100
	2,373,100	4,454,000
Net (decrease) increase in pension obligation	3,106,200	(467,300)
Pension obligation at beginning of year	37,893,000	38,360,300
Pension obligation at end of year (Note 5)	$ 40,999,200	$ 37,893,000

The accompanying notes are part of these financial statements.

NOTE 1 SUMMARY DESCRIPTION OF THE PLAN

The following description of the Local Authorities Pension Plan (the Plan) is a summary only. For a complete description of the Plan, reference should be made to the *Joint Governance of Public Sector Pension Plans Act*, Statutes of Alberta 2018, Chapter J-0.5 (Joint Governance Act) and the *Public Sector Pension Plans Act,* Revised Statutes of Alberta 2000, Chapter P-41 (PSPPA), and the *Local Authorities Pension Plan* Alberta Regulation 366/93, (LAPP Regulation), as amended, as were in effect prior to being repealed on March 1, 2019 (see Note 15). Unless otherwise stated, all terms that are not defined below have the meaning ascribed to them in the Plan. Should anything in Note 1 or the financial statements conflict with the legislation, the legislation shall apply.

a) GENERAL

The Plan is a contributory defined benefit pension plan for eligible employees of local authorities and approved public bodies. These include cities, towns, villages, municipal districts, hospitals, school divisions, school districts, colleges, technical institutes and certain commissions, foundations, agencies, libraries, corporations, associations and societies. The Plan is a registered pension plan as defined in the *Income Tax Act*. The Plan's registration number is 0216556. As of March 1, 2019, the Plan is also registered under the *Employment Pension Plans Act*, Statutes of Alberta 2012, Chapter E-8.1 (EPPA). As of December 31, 2018, the President of Treasury Board, Minister of Finance was the legal trustee of the Plan. As of March 1, 2019, LAPP Corporation is the trustee of the Plan (see Note 15) and is management for purposes of these financial statements. The Plan is governed collectively by the LAPP Sponsor Board and by LAPP Corporation, including its Board of Directors (the Board). The LAPP Sponsor Board has certain statutory functions with respect to the Plan under the Joint Governance Act, including making and amending a plan text, setting contribution rates, and establishing a funding policy. LAPP Corporation is the administrator of the Plan for all purposes of the EPPA, except to the extent that responsibility has been expressly assigned to the LAPP Sponsor Board.

b) PLAN FUNDING

Current service costs and any actuarial deficiency (see Note 14) are funded by employers and employees at contribution rates which together with investment earnings are expected to provide for all benefits payable under the Plan. The contribution rates in effect at December 31, 2018 were 9.39% (2017: 10.39%) of pensionable earnings up to the Canada Pension Plan's Year's Maximum Pensionable Earnings (YMPE) and 13.84% (2017: 14.84%) of pensionable earnings over the YMPE for employees, and 10.39% (2017: 11.39%) of pensionable earnings up to the YMPE and 14.84% (2017 15.84%) of pensionable earnings over the YMPE for employers. Pensionable earnings are subject to a limit (the salary cap) to ensure the pension accrual is not greater than the maximum pension benefit limit allowed under the *Income Tax Act*. In 2018, the pensionable earnings limit was $163,992 (2017: $162,312).

The contribution rates were reviewed by the Board in 2018 and, as a result, contribution rates were reduced effective January 1, 2019. The contribution rates in effect from January 1, 2019 are 8.39% of pensionable earnings up to the YMPE and 12.84% of pensionable earnings over the YMPE for employees, and 9.39% of pensionable earnings up to the YMPE and 13.84% of pensionable earnings over the YMPE for employers. Rates are to be reviewed at least once every three years based on recommendations of the Plan's actuary.

c) RETIREMENT BENEFITS

The Plan provides for a pension of 1.4% for each year of pensionable service based on the highest average salary over five consecutive years up to the average YMPE over the same five consecutive year period and 2.0% on the average salary over the average YMPE, up to the average salary cap for the same period. The maximum pensionable service that can be credited under the Plan is 35 years. Unreduced pensions are payable to members at retirement who have attained age 65, or have attained age 55 and the sum of their age and years of pensionable service equals at least 85. Members with a minimum of two years of membership or pensionable service may retire as early as age 55,with their pensions being reduced if the sum of their age and years of pensionable service is less than 85.

d) DISABILITY PENSIONS

Pensions may be payable to members who become totally disabled and retire early with at least two years of membership or pensionable service. Reduced pensions may be payable to members who become partially disabled and retire early with at least two years of membership or pensionable service.

e) DEATH BENEFITS

Death benefits are payable on the death of a member. If the member has at least two years of membership or pensionable service and a surviving pension partner, the surviving pension partner may choose to receive either a survivor pension or a lumpsum payment. For a beneficiary other than a pension partner, or where membership or pensionable service is less than two years, a lump sum payment will be made.

f) TERMINATION BENEFITS AND REFUNDS TO MEMBERS

Members who terminate with at least two years of membership or pensionable service and who are not immediately entitled to a pension may receive the commuted value for all years of membership, with the commuted value being subject to locking-in provisions. Any service purchased by the member on an elective basis that was wholly funded by the member is not included in the commuted value and is instead refunded as contributions with interest. If the remaining member contributions fund more than 50% of the benefit, that excess is paid as a cash refund. Alternatively, they may elect to receive a deferred pension. Members who terminate with fewer than two years of membership or pensionable service receive a refund of their contributions and interest. These payments are included as benefit payments on the statement of changes in net assets available for benefits.

g) PURCHASED SERVICE AND TRANSFERS

All elective service purchases are to be cost-neutral to the Plan. The actuarial present value of pension entitlements is paid when service is transferred out of the Plan under a transfer agreement. The cost to recognize service transferred into the Plan under a transfer agreement is the actuarial present value of the benefits that will be created as a result of the transfer.

NOTE 1 SUMMARY DESCRIPTION OF THE PLAN... CONTINUED

h) COST-OF-LIVING ADJUSTMENTS

Pensions payable are increased each year on January 1st by an amount equal to 60% of the increase in the Alberta Consumer Price Index. The increase is based on the increase during the twelve-month period ending on October 31st in the previous year. The increase is prorated for pensions that became payable within the year.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES

a) BASIS OF PRESENTATION

These financial statements are prepared on the going concern basis in accordance with Canadian accounting standards for pension plans. The Plan has elected to apply International Financial Reporting Standards (IFRS) for accounting policies that do not relate to its investment portfolio or pension obligation. The statements provide information about the net assets available in the Plan to meet future benefit payments and are prepared to assist Plan members and others in reviewing the activities of the Plan for the year.

b) CHANGE IN ACCOUNTING POLICY

Effective January 1, 2018, the Plan adopted the accounting standard IFRS 9 – Financial Instruments on a prospective basis. There was no impact on the financial position or performance of the Plan.

c) VALUATION OF INVESTMENTS

Investments are recorded at fair value. As disclosed in Note 3, the Plan's investments consist primarily of direct ownership in units of pooled investment funds ("the pools"). The pools are established by Ministerial Order 16/2014, being the Establishment and Maintenance of Pooled Funds, pursuant to the *Financial Administration Act* of Alberta, Chapter F-12, Section 45, and the *Alberta Investment Management Corporation Act* of Alberta, Chapter A-26.5, Section 15 and 20. Participants in pools include government and non-government funds and plans.

Contracts to buy and sell financial instruments in the pools are between the Province of Alberta and the third party to the contracts. Participants in the pools are not party to the contracts and have no control over the management of the pool and the selection of securities in the pool. Alberta Investment Management Corporation (AIMCo), a Crown corporation within the Ministry of Treasury Board and Finance, controls the creation of the pools and the management and administration of the pools including security selection. Accordingly, the Plan does not report the financial instruments of the pools on its statement of financial position.

The Plan becomes exposed to the financial risks and rewards associated with the underlying financial instruments in a pool when it purchases units issued by the pools and loses its exposure to those financial risks and rewards when it sells its units. The Plan reports its share of the financial risks in Note 4.

The fair value of units held by the Plan is derived from the fair value of the underlying financial instruments held by the pools as determined by AIMCo (see Note 3b). Investments in units are recorded in the Plan's accounts. The underlying financial instruments are recorded in the accounts of the pools. The pools have a market-based unit value that is used to distribute income to the pool participants and to value purchases and sales of the pool units. The pools include various financial instruments such as bonds, equities, real estate, derivatives, investment receivables and payables and cash.

The Plan's cut-off policy for valuation of investments, investment income and investment performance is based on valuations confirmed by AIMCo on the fourth business day following the year end. Differences in valuation estimates provided to Alberta Treasury Board and Finance after the year end cut-off date are reviewed by management. Differences considered immaterial by management are included in investment income in the following period.

Investments in pool units are recorded in the Plan's accounts on a trade date basis.

All purchases and sales of the pool units are in Canadian dollars.

Fair value is the amount of consideration agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

d) INVESTMENT INCOME

(a) Investment income is recorded on an accrual basis.

(b) Investment income is reported in the statement of changes in net assets available for benefits and in Note 8 and includes the following items recorded in the Plan's accounts:

i. Income distributions from the pools, based on the Plan's pro-rata share of total units issued by the pools; and

ii. Changes in fair value of units including realized gains and losses on disposal of units and unrealized gains and losses on units determined on an average cost basis.

e) INVESTMENT EXPENSES

Investment expenses include all amounts incurred by the Plan to earn investment income (see Note 11). Investment expenses are recorded on an accrual basis. Transaction costs are expensed as they are incurred.

f) VALUATION OF PENSION OBLIGATION

The value of the pension obligation and changes therein during the year are based on an actuarial valuation prepared by an independent firm of actuaries. The valuation is made at the beginning of the year, the results of which are then extrapolated to year-end. The valuation uses the projected benefit method pro-rated on service and Treasury Board and Finance's best estimate, as at the measurement date, of various economic and non-economic assumptions.

g) MEASUREMENT UNCERTAINTY

In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in the financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES... CONTINUED

the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty exists in the valuation of the Plan's pension obligation, private investments, hedge funds, real estate and timberland investments. Uncertainty arises because:

i) the Plan's actual experience may differ, perhaps significantly, from assumptions used in the extrapolation of the Plan's pension obligation, and

ii) The estimated fair values of the Plan's private investments, hedge funds, real estate and timberland investments may differ significantly from the values that would have been used had a ready market existed for these investments.

While best estimates have been used in the valuation of the Plan's pension obligation, private investments, hedge funds, real estate and timberland investments, it is possible, based on existing knowledge, that changes in future conditions in the short term could require a material change in the recognized amounts.

Differences between actual results and expectations in the Plan's pension obligation are disclosed as assumption or other changes and net experience gains or losses in the statement of changes in pension obligation in the year when actual results are known.

Differences between the estimated fair values and the amount ultimately realized for investments are included in net investment income in the year when the ultimate realizable values are known.

h) INCOME TAXES

The Plan is a registered pension plan, as defined by the *Income Tax Act* (Canada) and, accordingly, is not subject to income taxes.

NOTE 3 INVESTMENTS

The Plan's investments are managed at the asset class level for purposes of evaluating the Plan's risk exposure and investment performance against approved benchmarks based on fair value. During 2018, AIMCo invested the Plan's assets in accordance with the Statement of Investment Policy and Goals (SIP&G) approved by the LAPP Board of Trustees under the PSPPA. As of March 1, 2019, AIMCo invests the Plan's assets in accordance with the Statement of Investment Policies and Procedures (SIPP) approved by the Board. The fair value of the pool units is based on the Plan's share of the net asset value of the pooled fund. The pools have a market based unit value that is used to allocate income to participants of the pool and to value purchases and sales of pool units. AIMCo is delegated authority to independently purchase and sell securities in the pools and Plan, and units of the pools, within the ranges approved for each asset class (see Note 4).

Asset class	Fair Value Hierarchy [a] Level 2	Level 3	2018 Fair Value	2017 Fair Value
	($ thousands)			
Fixed income				
Deposits and short-term securities	$ 377,972	$ -	$ 377,972	$ 275,619
Bonds, mortgages and private debt	12,121,028	2,356,094	14,477,122	13,629,355
	12,499,000	2,356,094	14,855,094	13,904,974
Inflation sensitive and alternatives				
Real estate	-	6,619,908	6,619,908	5,144,234
Real return bonds	-	-	-	551,659
Infrastructure	-	3,954,757	3,954,757	3,069,267
Timberland	-	777,149	777,149	504,126
	-	11,351,814	11,351,814	9,269,286
Short horizon				
Canadian equities	3,354,053	-	3,354,053	3,668,203
Global developed equities	8,528,783	431,319	8,960,102	9,897,644
Emerging market equities	2,424,598	-	2,424,598	2,457,151
Small cap equity	1,983,002	-	1,983,002	2,135,009
	16,290,436	431,319	16,721,755	18,158,007
Long horizon				
Private equities	39	1,246,582	1,246,621	1,087,897
Strategic, tactical and currency investments *	23,430	239,440	262,870	298,926
Total investments	$ 28,812,905	$ 15,625,249	$ 44,438,154	$ 42,719,090

* This asset class is not listed separately in the SIP&G as it relates to strategic investments and currency overlays made on an opportunistic and discretionary basis (see Note 4).

a) **Fair Value Hierarchy:** The quality and reliability of information used to estimate the fair value of investments is classified according to the following fair value hierarchy with level 1 being the highest quality and reliability.

- ***Level 1*** - fair value is based on quoted prices in an active market. Although the pools may ultimately hold publicly traded listed equity investments, the pool units themselves are not listed in an active market and therefore cannot be classified as Level 1 for fair value hierarchy purposes. Pool units classified by the Plan as Level 2 may contain investments that might otherwise be classified as Level 1.

- ***Level 2*** - fair value is estimated using valuation techniques that make use of market-observable inputs other than quoted market prices. This level includes pool units that hold public equities, debt securities and derivative contracts totaling $28,812,905 (2017: $30,581,137).

- ***Level 3*** - fair value is estimated using inputs based on non-observable market data. This level includes pool units that hold private mortgages, hedge funds, private equities and inflation sensitive investments totaling $15,625,249 (2017: $12,137,953).

Year ended December 31, 2018 (All dollar amounts in thousands, except per member data)

NOTE 3 INVESTMENTS CONTINUED

Reconciliation of Level 3 Fair Value Measurement

	($ thousands) 2018	2017
Balance, beginning of year	$ 12,137,953	$ 10,623,852
Investment income *	1,483,753	809,196
Purchases of Level 3 pooled fund units	3,141,062	2,342,695
Sale of Level 3 pooled fund units	(1,137,480)	(1,637,790)
Level 3 transfers out	(39)	-
Balance, end of year	$ 15,625,249	$ 12,137,953

* Investment income includes unrealized gains (losses) of $1,172,088 (2017: $(161,429)).

b) Valuation of Financial Instruments recorded by AIMCo in the Pools

The methods used to determine the fair value of investments recorded in the pools are explained in the following paragraphs:

- ***Fixed income:*** Public interest-bearing securities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company. Private mortgages are valued based on the net present value of future cash flows. Cash flows are discounted using appropriate interest rate premiums over similar Government of Canada benchmark bonds trading in the market. Private debt and loans is valued similar to private mortgages.
- ***Inflation sensitive and alternatives:*** The estimated fair value of private real estate investments is reported at the most recent appraised value, net of any liabilities against the real property. Real estate properties are appraised annually by qualified external real estate appraisers. Appraisers use a combination of methods to determine fair value including replacement cost, direct comparison, direct capitalization of earnings and discounted cash flows. The fair value of timberland investments is appraised annually by independent third party evaluators. Infrastructure investments are valued similar to private equity investments.
- ***Short horizon:*** Public equities are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company. The fair value of hedge fund investments is estimated by external managers.
- ***Long horizon***: The fair value of private equities is estimated by managers or general partners of private equity funds, pools and limited partnerships. Valuation methods may encompass a broad range of approaches. The cost approach is used to value companies without either profits or cash flows. Established private companies are valued using the fair market value approach reflecting conventional valuation methods including discounted cash flows and earnings multiple analysis.
- ***Strategic, tactical and currency investments***: The estimated fair value of infrastructure investments held in emerging market countries are valued similar to private equities. For tactical asset allocations, investments in derivative contracts provides overweight or underweight exposure to global equity and bond markets, including emerging markets. Currency investments consist of directly held currency forward and spot contracts.

- ***Foreign currency:*** Foreign currency transactions in pools are translated into Canadian dollars using average rates of exchange. At year end, the fair value of investments in other assets and liabilities denominated in a foreign currency are translated at the year-end exchange rates.
- ***Derivative contracts:*** The carrying value of derivative contracts in a favourable and unfavourable position is recorded at fair value and is included in the fair value of pooled investment funds (see Note 4f). The estimated fair value of equity and bond index swaps is based on changes in the appropriate market-based index net of accrued floating rate interest. Interest rate swaps and cross-currency interest rate swaps are valued based on discounted cash flows using current market yields and exchange rates. Credit default swaps are valued based on discounted cash flows using current market yields and calculated default probabilities. Forward foreign exchange contracts and futures contracts are valued based on quoted market prices. Options to enter into interest rate swap contracts are valued based on discounted cash flows using current market yields and volatility parameters which measure changes in the underlying swap. Warrants and rights are valued at the year-end closing sale price or the average of the latest bid and ask prices quoted by an independent securities valuation company.

NOTE 4 INVESTMENT RISK MANAGEMENT

The Plan is exposed to financial risks associated with the underlying securities held in the pools created and managed by AIMCo. These financial risks include credit risk, market risk and liquidity risk. Credit risk relates to the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract. Market risk is comprised of currency risk, interest rate risk and price risk. Liquidity risk is the risk the Plan will not be able to meet its obligations as they fall due.

The investment policies and procedures of the Plan are clearly outlined in the SIP&G approved by the Board. The purpose of the SIP&G is to ensure the Plan is invested and managed in a prudent manner in accordance with current, accepted governance practices incorporating an appropriate level of risk. The Board manages the Plan's return-risk trade-off through asset class diversification, target ranges on each asset class, diversification within each asset class, quality constraints on fixed income instruments and restrictions on amounts exposed to countries designated as emerging markets. Forward foreign exchange contracts may be used to manage currency exposure in connection with securities purchased in a foreign currency (see Note 4b).

Year ended December 31, 2018 (All dollar amounts in thousands, except per member data)

NOTE 4 INVESTMENT RISK MANAGEMENT CONTINUED

Actuarial liabilities of the Plan are primarily affected by the long-term real rate of return expected to be earned on investments. In order to earn the best possible return at an acceptable level of risk, the Board has established the following asset mix policy ranges:

Asset Class	Target Asset Policy Mix	Actual Asset Mix 2018 ($ thousands)	2018 %	Actual Asset Mix 2017 ($ thousands)	2017 %
Fixed income	20 - 40%	$14,855,094	33.4	$13,904,974	32.6
Inflation sensitive and alternatives	20 - 50%	11,351,814	25.5	9,269,286	21.7
Short horizon	25 - 50%	16,721,755	37.7	18,158,007	42.5
Long horizon	3 - 9%	1,246,621	2.8	1,087,897	2.5
Strategic, tactical and currency investments	(a)	262,870	0.6	298,926	0.7
		$44,438,154	100.0	$42,719,090	100.0

(a) In accordance with the SIP&G, AIMCo may invest up to 1% of the fair value of the Plan's investments in strategic opportunities that are outside of the asset classes listed above. AIMCo may, at its discretion, invest the funds in currency overlays.

a) Credit Risk

i) Debt securities

The Plan is indirectly exposed to credit risk associated with the underlying debt securities held in the pools managed by AIMCo. Counterparty credit risk is the risk of loss arising from the failure of a counterparty to fully honour its financial obligations. The credit quality of financial assets is generally assessed by reference to external credit ratings. The credit rating of a debt security may be impacted by the overall credit rating of the counterparty, the seniority of the debt issue, bond covenants, maturity distribution and other factors. Credit risk can also lead to losses when issuers and debtors are downgraded by credit rating agencies usually leading to a fall in the fair value of the counterparty's obligations. Credit risk exposure for financial instruments is measured by the positive fair value of the contractual obligations with counterparties. The fair value of all investments reported in Note 3 is directly or indirectly impacted by credit risk to some degree. The majority of investments in debt securities have credit ratings considered to be investment grade. Unrated debt securities consist primarily of mortgages and private debt placements .

The table below summarizes the Plan's investments in debt securities by credit rating at December 31, 2018:

Credit rating	2018	2017
Investment Grade (AAA to BBB-)	83.7%	87.6%
Speculative Grade (BB+ or lower)	0.2%	0.2%
Unrated	16.1%	12.2%
	100.0%	100.0%

ii) Counterparty default risk - derivative contracts

The Plan is exposed to counterparty credit risk associated with the derivative contracts held in the pools. The maximum credit risk in respect of derivative financial instruments is the fair value of all contracts with counterparties in a favourable position (see Note 4f). AIMCo is responsible for selecting and monitoring derivative counterparties on behalf of the Plan.

AIMCo monitors counterparty risk exposures and actively seeks to mitigate counterparty risk by requiring that counterparties collateralize mark-to-market gains for the Plan. Provisions are in place to allow for termination of the contract should there be a material downgrade in a counterparty's credit rating. The exposure to credit risk on derivatives is reduced by entering into master netting agreements and collateral agreements with counterparties. To the extent that any unfavourable contracts with the counterparty are not settled, they reduce the Plan's net exposure in respect of favourable contracts with the same counterparty.

iii) Security lending risk

To generate additional income, the pools participate in a securities-lending program. Under this program, the custodian may lend investments held in the pools to eligible third parties for short periods. At December 31, 2018, the Plan's share of securities loaned under this program is $2,554,681 (2017: $5,556,675) and collateral held totals $2,725,004 (2017: $5,992,058). Securities borrowers are required to provide the collateral to assure the performance of redelivery obligations. Collateral may take the form of cash, other investments or a bank-issued letter of credit. All collateralization, by the borrower, must be in excess of 100% of investments loaned.

b) Foreign Currency Risk

The Plan is exposed to foreign currency risk associated with the underlying securities held in the pools that are denominated in currencies other than the Canadian dollar. Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The fair values of investments denominated in foreign currencies are translated into Canadian dollars using the reporting date exchange rate. As a result, fluctuations in the relative value of the Canadian dollar against these foreign currencies can result in a positive or negative effect on the fair value of investments. Approximately 34% (2017: 33%) of the Plan's investments, or $15,323,393 (2017: $14,303,578), are denominated in currencies other than the Canadian dollar, with the largest foreign currency exposure being to the US dollar, 17% (2017: 16%) and the Euro, 4% (2017: 3%).

If the value of the Canadian dollar increased by 10% against all other currencies, and all other variables are held constant, the potential loss to the Plan would be approximately 3.4% of total investments (2017: 3.3%).

The following table summarizes the Plan's exposure to foreign currency investments held in the pools at December 31, 2018:

	($ thousands)			
	2018		**2017**	
Currency [a]	**Fair Value**	**Sensitivity**	**Fair Value**	**Sensitivity**
U.S. dollar	$ 7,403,850	$ (740,385)	$ 6,872,683	$ (687,268)
Euro	1,748,084	(174,808)	1,485,262	(148,526)
British pound	1,357,171	(135,717)	869,569	(86,957)
Japanese yen	1,060,070	(106,007)	1,104,334	(110,433)
Hong Kong dollar	677,170	(67,717)	624,426	(62,443)
Other foreign currency	3,077,048	(307,705)	3,347,304	(334,731)
Total foreign currency investments	$ 15,323,393	$ (1,532,339)	$ 14,303,578	$ (1,430,358)

(a) Information on specific currencies is disclosed when the current year fair value is greater than 1% of the Plan's net assets.

Year ended December 31, 2018 (All dollar amounts in thousands, except per member data)

NOTE 4 INVESTMENT RISK MANAGEMENT CONTINUED

c) Interest Rate Risk

The Plan is exposed to interest rate risk associated with the underlying interest-bearing securities held in the pools managed by AIMCo. Interest rate risk relates to the possibility that the investments will change in value due to future fluctuations in market interest rates. In general, investment returns from bonds and mortgages are sensitive to changes in the level of interest rates, with longer term interest-bearing securities being more sensitive to interest rate changes than shorter-term bonds. If interest rates increased by 1%, and all other variables are held constant, the potential loss in fair value to the Plan would be approximately 3.3% of total investments (2017: 3.5%).

d) Price Risk

Price risk relates to the possibility that pool units will change in value due to future fluctuations in market prices of equities held in the pools caused by factors specific to an individual equity investment or other factors affecting all equities traded in the market. The Plan is exposed to price risk associated with the underlying equity investments held in pools managed by AIMCo. If equity market indices (S&P/TSX, S&P500, S&P1500 and MSCI ACWI and their sectors) declined by 10%, and all other variables are held constant, the potential loss in fair value to the Plan would be approximately 5.0% of total investments (2017: 5.2%).

e) Liquidity Risk

Liquidity risk is the risk that the Plan will encounter difficulty in meeting obligations associated with its financial liabilities. Liquidity requirements of the Plan are met through income generated from investments, employee and employer contributions, and by investing in pools that hold publicly traded liquid assets traded in an active market that are easily sold and converted to cash. Units in pools that hold private investments like real estate, timberland,infrastructure and private equities are less easily converted to cash since the underlying securities are illiquid because they take more time to sell. These sources of cash are used to pay pension benefits and operating expenses, purchase new investments, settle derivative transactions with counterparties and margin calls on futures contracts. The Plan's future liabilities include the accrued pension benefits obligation and exposure to net payables to counterparties (Note 4f).

f) Use of Derivative Financial Instruments in Pooled Investment Funds

The Plan has indirect exposure to derivative financial instruments through its investment in units of the pools. AIMCo uses derivative financial instruments to cost effectively gain access to equity markets in the pools, manage asset exposure within the pools, enhance pool returns and manage interest rate risk, foreign currency risk and credit risk in the pools.

		Plan's Indirect Share ($ thousands)	
By counterparty	Number of counterparties	**2018**	**2017**
Contracts in net favourable position (current credit exposure)	60	$ 981,203	$ 515,478
Contracts in net unfavourable position	17	(1,400,045)	(230,830)
Net fair value of derivative contracts	77	$ (418,842)	$ 284,648

(i) Current credit exposure: The current credit exposure is limited to the amount of loss that would occur if all counterparties to contracts in a net favourable position totaling $981,203 (2017: $515,478) were to default at once.

(ii) Cash settlements: Receivables or payables with counterparties are usually settled in cash every three months.

(iii) Contract notional amounts: The fair value of receivables (receive leg) and payables (pay leg) and the exchange of cash flows with counterparties in pooled funds are based on a rate or price applied to a notional amount specified in the derivative contract. The notional amount itself is not invested, received or exchanged with the counterparty and is not indicative of the credit risk associated with the contract. Notional amounts are not assets or liabilities and do not change the asset mix reported in Note 3. Accordingly, there is no accounting policy for their recognition in the statement of financial position.

	Plan's Indirect Share *($ thousands)*	
Types of derivatives used in pools	**2018**	**2017**
Structured equity replication derivatives	$ (190,639)	$ 99,141
Foreign currency derivatives	(239,722)	64,693
Interest rate derivatives	8,743	108,235
Credit risk derivatives	2,776	12,579
Net fair value of derivative contracts	$ (418,842)	$ 284,648

(i) Equity derivatives are structured to receive income from counterparties based on the performance of a specified market-based equity index, security or basket of equity securities applied to a notional amount in exchange for floating rate interest paid to the counterparty. Floating rate notes are held in equity pools to provide floating rate interest to support the pay leg of the equity derivatives. Rights, warrants, futures and options are also included as structured equity replication derivatives.

(ii) Foreign currency derivatives include contractual agreements to exchange specified currencies at an agreed upon exchange rate and on an agreed settlement date in the future.

(iii) Interest rate derivatives exchange interest rate cash flows (fixed to floating or floating to fixed) based on a notional amount. Interest rate derivatives primarily include interest rate swaps and cross currency interest rate swaps, futures contracts and options.

(iv) Credit risk derivatives include credit default swaps allowing the pools to buy and sell protection on credit risk inherent in a bond. A premium is paid or received, based on a notional amount in exchange for a contingent payment should a defined credit event occur with respect to the underlying security.

(v) At December 31, 2018, deposits in futures contracts margin accounts totaled $154,313 (2017: $47,239). Cash and non-cash collateral for derivative contracts pledged and received, respectively, totaled $(446,937) (2017: $(108,362)) and $5,517 (2017: $3,508).

NOTE 5 PENSION OBLIGATION

a) ACTUARIAL VALUATION AND EXTRAPOLATION ASSUMPTIONS

An actuarial valuation of the Plan was carried out as at December 31, 2017 by Aon Hewitt and results were then extrapolated to December 31, 2018.

The actuarial assumptions used in determining the value of the pension obligation of $40,999,200 (2017: $37,893,000) reflect management's best estimate, as at the measurement date, of future economic events and involve both economic and non-economic assumptions. The non-economic assumptions include considerations such as mortality as well as withdrawal and retirement rates. The primary economic assumptions include the discount rate, inflation rate and salary escalation rate. The discount rate is determined by taking the plan specific asset allocation and applying the average of the expected long term asset returns determined by independently developed investment models; less expected plan investment expenses; and an additive for diversification and rebalancing. It does not assume a return for active management beyond the passive benchmark.

Year ended December 31, 2018 (All dollar amounts in thousands, except per member data)

NOTE 5 PENSION OBLIGATION CONTINUED

The major assumptions used for accounting purposes were:

	2018	2017
	%	
Discount rate	5.70	6.00
Inflation rate	2.00	2.00
Salary escalation rate*	3.00	3.00
Mortality rate	2014 Canadian Pension Mortality Table (Public Sector) with a LAPP specific multiplier	

* In addition to age specific merit and promotion increase assumptions.

The Board's policy is to have an actuarial valuation of the Plan carried out every year. As a result, an actuarial valuation of the Plan as at December 31, 2018 will be carried out subsequent to the completion of these financial statements. Any differences between the actuarial valuation results and extrapolation results as reported in these financial statements will affect the financial position of the Plan and will be accounted for as gains or losses in 2019.

b) NET EXPERIENCE GAINS

Net experience gains of $713,700 (2017: $78,700) arose from differences between the actuarial assumptions used in the 2017 valuation and 2018 extrapolation for reporting compared to actual results.

c) SENSITIVITY OF CHANGES IN MAJOR ASSUMPTIONS

The Plan's future experience will differ, perhaps significantly, from the assumptions used in the actuarial valuation and extrapolation. Any differences between the actuarial assumptions and future experience will emerge as gains or losses in future valuations and will affect the financial position of the Plan.

The following is a summary of the sensitivities of the Plan's deficiency and current service cost to changes in assumptions used in the actuarial extrapolation at December 31, 2018:

	($ thousands)		
	Changes in Assumptions %	Increase in Plan Deficiency $	Increase in Current Service Cost as a % of Pensionable Earnings (1)
Inflation rate increase holding discount rate and salary escalation assumptions constant	1.0	2,580,547	0.9
Salary escalation rate increase holding inflation rate and discount rate assumptions constant	1.0	1,845,347	1.7
Discount rate decrease holding inflation rate and salary escalation assumptions constant	(1.0)	6,196,647	3.4

(1) The current service cost as a percentage of pensionable earnings as determined by the December 31, 2018 extrapolation was 16.83%.

NOTE 6 SURPLUS (DEFICIT)

	($ thousands) 2018	2017
Surplus (Deficit) at beginning of year	$ 4,835,515	$ (637,357)
Increase in net assets available for benefits	1,740,032	5,005,572
Net decrease (increase) in pension obligation	(3,106,200)	467,300
Surplus (Deficit) at end of year	$ 3,469,347	$ 4,835,515

NOTE 7 CONTRIBUTIONS

	($ thousands) 2018	2017
Current service		
Employers	$ 1,298,964	$ 1,364,992
Employees	1,188,331	1,258,264
Past service		
Employers	15,496	7,689
Employees	33,692	23,845
	$ 2,536,483	$ 2,654,790

NOTE 8 INVESTMENT INCOME

The following is a summary of the Plan's investment income (loss) by asset class:

($ thousands)	Income	Change in Fair Value	2018 Total	2017 Total
Fixed Income	$ 491,058	$ (181,385)	$ 309,673	$ 641,744
Inflation sensitive and alternatives				
Real estate	225,094	527,836	752,930	463,556
Real return bonds	11,480	(13,803)	(2,323)	(4,359)
Infrastructure	109,572	392,574	502,146	221,942
Timberland	35,920	50,613	86,533	71,778
	382,066	957,220	1,339,286	752,917
Short horizon				
Canadian equities	138,454	(472,851)	(334,397)	384,976
Foreign equities	851,133	(1,236,116)	(384,983)	2,274,673
	989,587	(1,708,967)	(719,380)	2,659,649
Long horizon				
Private equities	(46,123)	228,644	182,521	46,140
Strategic, tactical and currency investments	11,691	2,536	14,227	24,079
	$ 1,828,279	$ (701,952)	$ 1,126,327	$ 4,124,529

The change in fair value includes realized and unrealized gains and losses on pool units and currency hedges. Realized and unrealized gains and losses on pool units total $9,247 and $(715,183) respectively (2017: $724,974 and $(141,882) respectively). Realized and unrealized gains and losses on currency hedges total $142 and $3,842 respectively (2017: $(344) and $(402) respectively).

Year ended December 31, 2018 (All dollar amounts in thousands, except per member data)

NOTE 8 INVESTMENT INCOME CONTINUED

Income earned in pooled investment funds is distributed to the Plan daily based on the Plan's pro rata share of units issued by the pool. Income earned by the pools is determined on an accrual basis and includes interest, dividends, security lending income, realized gains and losses on sale of securities determined on an average cost basis and income and expense on derivative contracts.

NOTE 9 INVESTMENT RETURNS, CHANGE IN NET ASSETS AND PENSION OBLIGATION

The following is a summary of investment returns (losses), and the annual change in net assets compared to the annual change in the pension obligation and the per cent of pension obligation supported by net assets:

	2018	2017	2016	2015	2014
			in per cent		
Increase in net assets attributed to:					
Investment income					
Policy benchmark return on investments	1.0	9.0	6.0	6.7	12.9
Value added (lost) by AIMCo	1.0	1.1	(0.2)	1.2	(1.5)
Time weighted rate of return, at fair value [(a)]	**2.0**	**10.1**	**5.8**	**7.9**	11.4
Other sources [(b)]	2.2	3.2	3.8	3.9	4.6
Per cent change in net assets [(c)]	**4.1**	**13.3**	**9.6**	**11.8**	**16.0**
Per cent change in pension obligation [(c)]	**8.2**	**(1.2)**	**8.5**	**6.3**	**5.8**
Per cent of pension obligation supported by net assets	**108**	**113**	**98**	**97**	**93**

(a) All investment returns are provided by AIMCo and are net of investment expenses. The annualized total return and policy benchmark return (PBR) on investments over five years is 7.4% (PBR: 7.0%), ten years is 8.6% (PBR: 8.3%) and twenty years is 6.6% (PBR: 6.4%). The Plan's actuary estimates the long-term net investment return on assets for funding purposes to be 5.4% (2017: 5.3%).

(b) Other sources includes employee and employer contributions and transfers from other plans, net of benefit payments, transfers to other plans and administration expenses.

(c) The percentage change in net assets and the pension obligation is based on the amounts reported on the statement of changes in net assets available for benefits and the statement of changes in pension obligation.

NOTE 10 BENEFIT PAYMENTS

	($ thousands)	
	2018	**2017**
Retirement benefits	$ 1,193,973	$ 1,094,749
Disability pensions	8,652	8,542
Termination benefits	332,691	321,585
Death benefits	74,548	77,977
	$ 1,609,864	$ 1,502,853

NOTE 11 INVESTMENT EXPENSES

	($ thousands) 2018	2017
Amounts charged by AIMCo for:		
Investment costs [(a)]	$ 208,409	$ 179,655
Performance based fees [(a)]	54,505	44,212
GST [(b)]	8,582	9,468
	271,496	233,335
Amounts charged by Treasury Board and Finance for:		
Investment accounting and Plan reporting	52	52
Total investment expenses	$ 271,548	$ 233,387
Increase in expenses [(a)]	16.4%	34.0%
Increase in average investments under management	8.4%	11.7%
Increase in value of investments attributed to AIMCo	1.0%	1.1%
Investment expenses as a percent of dollar invested	0.6%	0.6%
Investment expenses per member	$ 1,022	$ 899

(a) Investment expenses are charged by AIMCo on a cost-recovery basis. Please refer to AIMCo's financial statements for a more detailed breakdown of the types of expenses incurred by AIMCo. Amounts recovered by AIMCo for investment costs include those costs that are primarily non-performance related including external management fees, external administration costs, employee salaries and incentive benefits and overhead costs. Amounts recovered by AIMCo for performance based fees relate to external managers hired by AIMCo.

The per cent increase in investment costs and performance based fees is 17.4% (2017: 32.7%).

(b) GST includes $nil (2017: $2,156) which was recorded as a receivable in prior years but determined to be unrecoverable and was expensed in the year.

NOTE 12 ADMINISTRATIVE EXPENSES

	($ thousands) 2018	2017
General administration costs and process improvement costs		
Alberta Pensions Services Corporation (APS)	$ 37,370	$ 36,482
Alberta Local Authorities Pension Plan Corporation (ALAPP Corp.)	2,704	2,350
Actuarial fees	123	218
	40,197	39,050
Member service expenses per member	$ 151	$ 150

General administration costs and process improvement costs, including the Board costs were paid to APS and ALAPP Corp. on a cost-recovery basis.

The Plan's share of APS's operating and plan specific costs were based on cost allocation policies approved by the President of Treasury Board, Minister of Finance.

Year ended December 31, 2018 (All dollar amounts in thousands, except per member data)

NOTE 12 ADMINISTRATIVE EXPENSES CONTINUED

ALAPP Corp. costs include remuneration to senior officials and the Board members as follows:

($ thousands)

	2018				2017
	Base Salary (a)	Other Cash Benefits (b)	Other Non-Cash Benefits (c)	Total	Total
Corporation Board Chair	$ -	$ -	$ -	$ -	$ -
Corporation Board Members (excluding Chair)	-	85	-	85	81
President & Chief Executive Officer	248	70	60	378	376
Vice-Presidents:					
Investment Policy & Risk Mgmt (d)	150	25	34	209	205
Pension Policy & Funding (e)	175	31	41	247	229
Stakeholder Relations & Communications	157	29	36	222	222

(a) Base salary includes regular base pay.

(b) Other cash benefits include incentive pay, lump sum payments, vacation payouts and car allowance honoraria. Board members only receive remuneration pay. Remuneration is paid in accordance with the fee structure approved by the Minister of Finance.

(c) Other non-cash benefits include the Corporation's share of all employees' benefits and contributions or payments made on their behalf including pension, health care, dental coverage, professional memberships and group life insurance.

(d) 2017 compensation did not encompass an entire year of base pay.

(e) For 11 months salary in 2017.

NOTE 13 TOTAL PLAN EXPENSES

Total Plan expenses of investment expenses per Note 11 and member service expenses per Note 12 are $311,745 (2017: $272,437) or $1,173 (2017: $1,049) per member and 0.70% (2017: 0.64%) of net assets under administration.

NOTE 14 CAPITAL

The Plan defines its capital as the funded status. In accordance with the *Public Sector Pension Plans Act*, the actuarial surplus or deficit is determined by an actuarial funding valuation performed, at a minimum, every three years. The objective is to ensure that the Plan is fully funded over the long term through the management of investments, contribution rates and benefits. Investments, the use of derivatives and leverage are based on an asset mix and risk policies and procedures that are designed to enable the Plan to meet or exceed its long-term funding requirement within an acceptable level of risk, consistent with the Plan's SIP&G approved by the Board.

The Plan's asset values are determined on the fair value basis for accounting purposes. However for funding valuation purposes, asset values are adjusted for fluctuations in fair values to moderate the effect of market volatility on the Plan's funded status. Actuarial asset value for funding valuation purposes amounted to $44,953,900 at December 31, 2018 (2017: $41,048,800).

NOTE 15 SUBSEQUENT EVENT

On the transition date of March 1, 2019 the Plan transitioned to a joint governance structure in accordance with the Joint Governance Act, which received Royal Assent on December 11, 2018. On the transition date, the LAPP Regulation and the portions of the PSPPA applicable to the Plan were repealed. On the transition date, ownership of the Plan fund transferred from the Minister as trustee to the newly established LAPP Corporation as trustee. The assets of the Plan shall continue to be held in trust for members of the Plan and others entitled to benefits under the Plan. All members and employers participating in the Plan immediately prior to the transition date continue to be participating members and employers of the Plan.

On the transition date, LAPP Corporation became the administrator and trustee of the Plan. As of the transition date, the Minister and the Crown have no responsibilities, functions, obligations, duties or liabilities in relation to administration of the Plan. There is no change to Plan benefits or how the Plan is funded or impact to net assets available for benefits of the Plan as a result of joint governance.

NOTE 16 COMPARATIVE FIGURES

Comparative figures related to the fair value hierarchy in Note 3 have been reclassified to conform to the presentation adopted in 2018. The current classification of investments within the hierarchy reflects the quality and reliability of the valuation of the pool unit. Previous presentation reflected the quality and reliability of the valuation of significant securities held within the pools.

NOTE 17 RESPONSIBILITY FOR FINANCIAL STATEMENTS

These financial statements were approved by the Board of Directors of LAPP Corporation based on information provided by Treasury Board and Finance, APS, AIMCo and the Plan's Actuary.

lapp | Local Authorities Pension Plan

For more information on LAPP visit www.lapp.ca.

lapp | Local Authorities Pension Plan