

**City of Pontiac  
General Employees' Retirement System**

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**Financial Report  
with Required Supplemental Information  
December 31, 2006**

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# **City of Pontiac General Employees' Retirement System**

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## Independent Auditor's Report

To the Retirement Board  
City of Pontiac General Employees'  
Retirement System

We have audited the accompanying statement of plan net assets of the City of Pontiac General Employees' Retirement System (a component unit of the City of Pontiac, Michigan) as of December 31, 2006 and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the General Employees' Retirement Board of the City of Pontiac. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac General Employees' Retirement System as of December 31, 2006 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and required supplemental information (identified in the table of contents) are not required parts of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

*Plante & Moran, PLLC*

June 12, 2007

# City of Pontiac General Employees' Retirement System

## Management's Discussion and Analysis

### Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The financial statements are followed by a section of required supplemental information that further explains and supports the information in the financial statements.

### Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	2006	2005
Total assets	\$ 470,400,620	\$ 489,069,164
Total liabilities:		
Amounts due broker under securities lending agreement	-	52,857,655
Other liabilities	814,096	754,175
Total liabilities	814,096	53,611,830
Assets held in trust for pension benefits	<u>\$ 469,586,524</u>	<u>\$ 435,457,334</u>
Net investment gain	\$ 52,733,490	\$ 23,113,895
Net securities lending income	105,835	100,187
Contributions:		
Employee - Reinstated members	13,719	20,291
Employer	15,695	16,926
Retiree pension and annuity benefits	18,214,565	16,562,544
Benefits paid in excess of contributions	18,185,151	16,525,327
General and administrative expenses	524,984	660,931
Net increase in net assets held in trust	<u>\$ 34,129,190</u>	<u>\$ 6,027,824</u>

# **City of Pontiac General Employees' Retirement System**

## **Management's Discussion and Analysis (Continued)**

### **Overall Fund Structure and Objectives**

The City of Pontiac General Employees' Retirement System (the "System") exists to pay benefits to its members and retirees. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

### **Asset Allocation**

The System has established asset allocation policies which are expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following is a summary of the adopted asset allocation as of December 31, 2006:

Domestic equities	55%
International equities	10%
Domestic fixed income	25%
Real estate	5%
Private equity	5%

### **Investment Results**

In 2006, the stock market remained attractive relative to the bond market as the S&P 500 earnings yield outpaced the 30-year Treasury yield. The bond market was up modestly as the Fed kept interest rates steady toward the end of the year. The domestic equity market grew from last year. The S&P 500 ended the year up 15.8 percent. The fixed income market, measured by the Lehman Aggregate Index, returned 4.6 percent for the year. The international index, MSCI EAFE, was up 10.4 percent for the quarter and 26.3 percent for the year. The total fund excluding real estate returned 11.8 percent for the year.

The System's total fund return must always be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the System to pay the benefits promised to members and retirees are very long-term obligations. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the System over many years, not just one or two years.

# City of Pontiac General Employees' Retirement System

## Statement of Plan Net Assets December 31, 2006

### Assets

Cash (Note 3)	\$ 100,735
Accrued interest and dividends receivable	1,534,319
Accounts receivable:	
Due from City of Pontiac Police and Fire Retirement System	8,945
Due from broker for pending transactions	321,495
Due from GERS VEBA	72,543
Other receivable	3,098
Investments at fair value - Including loaned securities (Note 3):	
Money market funds	22,446,179
U.S. government agency notes and debentures	14,130,412
Corporate and other bonds	72,414,436
Equities	307,310,871
U.S. government agency mortgage pools	35,363,610
Real estate	<u>16,693,977</u>
Total investments	<u>468,359,485</u>
Total assets	470,400,620

### Liabilities

Due to City of Pontiac	116,191
Accounts payable	<u>697,905</u>
Total liabilities	<u>814,096</u>

**Net Assets Held in Trust for Pension Benefits** (a schedule of funding progress is presented in the required supplemental information)

**\$ 469,586,524**

# City of Pontiac General Employees' Retirement System

## Statement of Changes in Plan Net Assets Year Ended December 31, 2006

### Additions

Investment income:	
Interest and dividend income	\$ 15,457,978
Net appreciation in fair value	39,471,506
Investment advisor fees	<u>(2,195,994)</u>
Net investment income	52,733,490
Securities lending income:	
Interest and fees	2,116,381
Less borrower rebates and bank fees	<u>(2,010,546)</u>
Net securities lending income	105,835
Contributions:	
Employer	15,695
Employee - Reinstated members	<u>13,719</u>
Total additions	52,868,739

### Deductions

Retirees' pension benefits and retirement incentives	18,214,565
Other expenses	271,011
Charges from the City of Pontiac - Administrative expenses	<u>253,973</u>
Total deductions	<u>18,739,549</u>
<b>Net Increase in Net Assets Held in Trust for Pension Benefits</b>	<b>34,129,190</b>
<b>Net Assets Held in Trust for Pension Benefits - January 1, 2006</b>	<b><u>435,457,334</u></b>
<b>Net Assets Held in Trust for Pension Benefits - December 31, 2006</b>	<b><u>\$ 469,586,524</u></b>

# City of Pontiac

## General Employees' Retirement System

Notes to Financial Statements  
December 31, 2006

### Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers the General Employees' Retirement System (the "System") (a contributory single-employer retirement plan) that covers substantially all employees of the City, except police and fire employees.

**Reporting Entity** - The financial statements of the System are also included in the combined financial statements of the City as a pension trust fund. The assets of the pension trust fund include no securities of or loans to the City or any other related party. At December 31, 2006, there were no investments in any one organization in excess of 5 percent of net assets available for benefits.

**Basis of Accounting** - The System's financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

**Methods Used to Value Investments** - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals or audited financial statements.

### Note 2 - Plan Description and Contribution Information

At December 31, 2005, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving pension benefits and terminated employees entitled to benefits but not yet receiving them	<u>1,331</u>
Current employees:	
Fully vested	129
Nonvested	<u>242</u>
Total current employees	<u>371</u>



# **City of Pontiac General Employees' Retirement System**

**Notes to Financial Statements  
December 31, 2006**

## **Note 2 - Plan Description and Contribution Information (Continued)**

**Plan Description** - The System provides retirement benefits, as well as death and disability benefits. Employees may receive cost of living adjustments as a percentage of their base amount, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the System was established by City ordinance and negotiation with the employees' collective bargaining units.

**Contributions** - Plan members are not required to contribute. The City is required to contribute at an actuarially determined rate. During the year, only the Stadium Authority Division had a required contribution. Administrative costs are financed through investment earnings.

## **Note 3 - Deposits and Investments**

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The System is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The System is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the trust fund's assets exceed \$250 million), debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

# City of Pontiac

## General Employees' Retirement System

Notes to Financial Statements  
December 31, 2006

### Note 3 - Deposits and Investments (Continued)

The System has designated one bank for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all allowable investments under Michigan Public Act 314 of 1965, as amended. The System's deposits and investment policies are in accordance with statutory authority. The System's cash and investments are subject to several types of risk, which are examined in more detail below:

#### Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the System's deposits may not be returned to it. The System does not have a deposit policy for custodial credit risk. At year end, the System had approximately \$1,000 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The System believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the System evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

#### Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System's investment policy does not restrict investment maturities. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
Money market funds	\$ 22,688,758	.08 years
Corporate and other bonds	73,141,635	7.03 years
U.S. government agency notes and debentures	14,339,591	11.78 years
U.S. government agency mortgage pools	35,571,833	21.75 years

# City of Pontiac General Employees' Retirement System

Notes to Financial Statements  
December 31, 2006

## Note 3 - Deposits and Investments (Continued)

### Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The System's investment policy limits investments in domestic fixed-income securities to not less than a CCC rating for an overall average quality of each high-yield portfolio; the overall quality rating of each high-grade portfolio must be AA or an equivalent rating; for domestic equity investments, the securities must be the equivalent of Standard & Poor's A1 or Moody's P-1; for global bonds, the overall average quality must be AA or higher. As of year end, the credit quality ratings of debt securities are as follows:

Investment Type	Fair Market	
	Value	Moody's Rating
Corporate and other bonds	\$ 5,824,969	A1
Corporate and other bonds	2,733,188	A2
Corporate and other bonds	2,064,521	A3
Corporate and other bonds	5,077,301	AA1
Corporate and other bonds	961,917	AA2
Corporate and other bonds	7,658,263	AA3
Corporate and other bonds	8,538,392	AAA
Corporate and other bonds	215,957	B1
Corporate and other bonds	2,591,381	B2
Corporate and other bonds	1,965,427	B3
Corporate and other bonds	1,012,306	BAA1
Corporate and other bonds	1,898,814	BAA2
Corporate and other bonds	751,310	BAA3
Corporate and other bonds	806,104	CAA1
Corporate and other bonds	2,045,446	CAA2
Corporate and other bonds	489,894	CAA3
Corporate and other bonds	28,506,445	Unrated
U.S. government agency mortgage pools	1,032,285	AA2
U.S. government agency mortgage pools	25,236,150	U.S. Agency
Money market funds	22,895,115	Unrated

# City of Pontiac General Employees' Retirement System

Notes to Financial Statements  
December 31, 2006

## Note 3 - Deposits and Investments (Continued)

### Concentration of Credit Risk

The System places no limit on the amount it may invest in any one issuer. The investment in CAPROC, totaling approximately \$11,368,000, represents approximately 2.4 percent of the System's net assets. Two of the 12 members on the CAPROC board are General Employees' Retirement System trustees.

### Foreign Currency Risk

Foreign currency risk is the risk that an investment denominated in the currency of a foreign country could reduce its U.S. dollar value as a result of changes in foreign currency exchange rates. The pension system limits total assets in international equities and fixed income funds to 10 percent of the total pension systems market value. The following securities are subject to foreign currency risk:

	Fair Market Value	Mutual Funds	Equity
Australian Dollar	\$ 8,886	\$ 263	\$ 8,623
British Pound Sterling	19,838	34	19,804
Danish Krone	44	44	-
Euro Currency Unit	85,513	2,296	81,217
Hong Kong Dollar	195,369	195,369	-
Japanese Yen	1,983	1,983	-
Malaysian Ringgit	101	-	101
Mexican New Peso	2	2	-
Polish Zloty	30,275	2,482	27,793
Romanian Leu	4,935	430	4,505
Russian Rubel (New)	12,735	451	12,284
S. African Comm Rand	1	1	-
Singapore Dollar	13	13	-
Swiss Franc	32,413	32,413	-
Ukraine Hryvana	48,767	-	48,767

# **City of Pontiac General Employees' Retirement System**

## **Notes to Financial Statements December 31, 2006**

### **Note 3 - Deposits and Investments (Continued)**

As permitted by state statutes and under the provisions of a securities lending authorization agreement, the System lends securities to broker-dealers and banks for collateral that will be returned for the same securities in the future. The System's custodial bank manages the securities lending program and receives cash as collateral. Borrowers are required to deliver collateral for each loan equal to not less than 100 percent of the market value of the loaned securities. During the year ended December 31, 2006, only United States currency was received as collateral.

The System did not impose any restrictions during the fiscal year on the amount of loans made on its behalf by the custodial bank. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or custodial bank.

The General Employees' Retirement System and the borrower maintain the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other lenders, in an investment pool. Because the loans are terminable on demand, their duration did not generally match the duration of the investments made with cash collateral. On December 31, 2006, the System had no securities on loan.

### **Note 4 - Reserves**

State law requires employee contributions to be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of December 31, 2006, the System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 3,689,369
Reserved for retired employees	185,562,003

### **Note 5 - Subsequent Event**

During April 2007, the System entered into a buy-out agreement related to certain investments in real estate. In exchange for the System's interest in the investment, the System received \$1,775,000 of cash at closing and entered into a note for the balance of approximately \$10,890,000, including accrued interest of \$220,000. The investment was valued at \$12,378,000 as of December 31, 2006.

## **Required Supplemental Information**

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# City of Pontiac General Employees' Retirement System

## Required Supplemental Information Schedule of Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/00*	\$ 378,063,942	\$ 217,942,909	\$ (160,121,033)	173.5	\$ 18,728,688	-
12/31/01**	395,743,819	227,901,435	(167,842,384)	173.6	19,887,803	-
12/31/02*	393,214,033	235,422,367	(157,791,666)	167.0	20,039,136	-
12/31/03	394,367,065	247,396,857	(146,970,208)	159.4	20,807,612	-
12/31/04	394,807,254	258,365,787	(136,441,467)	152.8	21,320,477	-
12/31/05	391,409,757	260,103,260	(131,306,497)	150.5	16,751,815	-

\* Plan amended

\*\* Certain assumptions revised

# City of Pontiac General Employees' Retirement System

## Required Supplemental Information Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
1999	\$ 133,572	218.9
2000	175,021	100.0
2001	139,583	119.0
2002	46,888	166.0
2003	10,608	100.0
2004	2,767	392.9
2005	16,926	100.0
2006	15,695	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2005, the latest actuarial valuation, is as follows:

Actuarial cost method	Individual entry age normal cost
Amortization method	Level percent of payroll
Remaining amortization period	30 years, open
Asset valuation method	Market value with five-year smoothing of gains and losses
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	4.5% to 9.4%
*Includes inflation at	4.5%
Cost of living adjustments	2% (2.5% Court/MAPE) of original amount, subject to a maximum that varies by group