

City of Pontiac
Police and Fire Retirement System

Financial Report
with Required Supplemental Information
December 31, 2007

City of Pontiac Police and Fire Retirement System

Contents

Report Letter	1
Management's Discussion and Analysis	2-3
Basic Financial Statements	
Statement of Plan Net Assets	4
Statement of Changes in Plan Net Assets	5
Notes to Financial Statements	6-10
Required Supplemental Information	11
Schedule of Analysis of Funding Progress	12
Schedule of Employer Contributions	13

Independent Auditor's Report

To the Retirement Board
City of Pontiac Police and Fire
Retirement System

We have audited the accompanying statement of plan net assets of City of Pontiac Police and Fire Retirement System (a component unit of the City of Pontiac, Michigan) as of December 31, 2007 and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Police and Fire 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 City of Pontiac Police and Fire Retirement System as of December 31, 2007 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 20, 2008

City of Pontiac

Police and Fire 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:

	2007	2006
Total assets	\$ 320,511,511	\$ 268,748,496
Total liabilities:		
Amounts due broker under securities lending agreement	37,597,497	-
Other liabilities	492,108	683,305
Total liabilities	38,089,605	683,305
Assets held in trust for pension benefits	\$ 282,421,906	\$ 268,065,191
Net investment income	\$ 24,843,085	\$ 28,773,344
Net securities lending income	66,320	22,776
Contributions:		
Employee	329,993	340,825
Employer	2,344,231	2,324,011
Other - Miscellaneous and litigation revenue	888,486	-
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	13,285,926	13,054,385
Member refunds and withdrawals	458,782	159,866
Total benefits paid	13,744,708	13,214,251
Benefits paid in excess of contributions	11,070,484	10,549,415
Ratio of benefits paid to contributions	514.0%	495.9%
General and administrative expenses	370,692	293,988
Net increase in net assets held in trust	\$ 14,356,715	\$ 17,952,717

City of Pontiac Police and Fire Retirement System

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

City of Pontiac Police and Fire Retirement System (the "Retirement 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 Retirement System has established asset allocation policies which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Retirement System. The following is a summary of the asset allocation as of December 31, 2007:

Domestic equities	41%
International equities	14%
Domestic fixed income	37%
Real estate	8%

Investment Results

In 2007, defaulting sub-prime mortgages triggered a global credit crisis in the summer of 2007. In the aftermath, the equity markets declined, giving back a significant portion of the gains garnered in the first six months. Treasuries rallied as investors sought the safety of guaranteed bonds. The domestic equity market declined as compared to last year. The S&P 500 ended the year up 5.5 percent. The fixed income market, as measured by the Lehman Aggregate Index, returned 7.0 percent for the year. The international index, MSCI EAFE, was down 1.8 percent for the quarter and up 11.2 percent for the year. The total fund returned 9.1 percent for the year.

The Retirement 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 Retirement 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 Retirement System over many years, not just one or two years.

City of Pontiac

Police and Fire Retirement System

Statement of Plan Net Assets December 31, 2007

Assets

Cash (Note 3)	\$ 100,748
Cash and investments held as collateral for securities lending (Note 3)	37,597,497
Accrued interest and dividends receivable	395,795
Accounts receivable:	
Due from City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust	19,150
Due from City of Pontiac	293,439
Other	7,767
Total accounts receivable	320,356
Investments at fair value (Note 3):	
Money market and mutual funds	7,668,543
U.S. government obligations	9,319,543
Corporate and other bonds	27,503,225
Equities	163,738,045
U.S. government agency mortgage pools	15,464,398
Commercial mortgage pools	2,355,339
Asset-backed securities	991,638
Other fixed income	37,803,218
Other	17,253,166
Total investments	282,097,115
Total assets	320,511,511

Liabilities

Accounts payable and other liabilities	333,281
Due to City of Pontiac General Employees' Retirement System	158,827
Amounts due to broker under securities lending agreement (Note 3)	37,597,497
Total liabilities	38,089,605

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

\$ 282,421,906

City of Pontiac

Police and Fire Retirement System

Statement of Changes in Plan Net Assets Year Ended December 31, 2007

Additions

Investment income (loss):	
Interest and dividend income	\$ 3,850,525
Net appreciation in fair value	22,065,260
Investment advisor fees	<u>(1,072,700)</u>
Net investment income	24,843,085
Securities lending income (loss):	
Interest and fees	1,488,597
Less borrower rebates	<u>(1,422,277)</u>
Net securities lending income	66,320
Contributions:	
Employee	329,993
Employer	<u>2,344,231</u>
Total contributions	2,674,224
Other - Miscellaneous and litigation revenue	<u>888,486</u>
Total additions	28,472,115

Deductions

Retirees' pension benefits and retirement incentives	13,285,926
Member refunds and withdrawals	458,782
Other expenses	251,174
Charges from City - Administrative expenses	<u>119,518</u>
Total deductions	<u>14,115,400</u>

Net Increase in Net Assets Held in Trust for Pension Benefits	14,356,715
Net Assets Held in Trust for Pension Benefits - January 1, 2007	<u>268,065,191</u>
Net Assets Held in Trust for Pension Benefits - December 31, 2007	<u>\$ 282,421,906</u>

City of Pontiac Police and Fire Retirement System

Notes to Financial Statements
December 31, 2007

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers City of Pontiac Police and Fire Retirement System (the "Retirement System") (a contributory single-employer retirement plan) that covers all police and fire employees of the City.

Reporting Entity - The financial statements of the Retirement System are also included in the combined financial statements of the City of Pontiac 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.

Basis of Accounting - The Retirement System's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions 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, 2006, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	<u>367</u>
Current employees:	
Fully vested	150
Nonvested	<u>77</u>
Total	<u>227</u>

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2007

Note 2 - Plan Description and Contribution Information (Continued)

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

Contributions - Plan members are required to contribute 2.5 percent of their annual salaries. The Retirement System is required to contribute at an actuarially determined rate. 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 Retirement 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 Retirement 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.

The Retirement 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 Retirement System's deposits and investment policies are in accordance with statutory authority. The Retirement System's cash and investments are subject to several types of risk, which are examined in more detail below:

City of Pontiac
Police and Fire Retirement System

Notes to Financial Statements
December 31, 2007

Note 3 - Deposits and Investments (Continued)

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Retirement System's deposits may not be returned to it. The Retirement System does not have a deposit policy for custodial credit risk. At year end, the Retirement System had approximately \$1,000 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Retirement 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 Retirement 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 Retirement System's investment policy restricts the average duration of an actively managed portfolio to not differ from the benchmark duration by more than 30 percent. At year end, the average maturities of investments are as follows:

Investment	Fair Market Value	Effective Duration
Asset-backed securities	\$ 991,638	.641 years
Corporate and other bonds	11,318,860	3.23 years
Corporate and other bonds	16,184,365	Unavailable
U.S. government obligations	9,319,543	8.25 years
U.S. government agency mortgage pools:		
Government agencies	8,436,985	3.17 years
Government mortgage-backed securities	3,683,153	2.65 years
Government mortgage-backed securities	3,344,260	Unavailable
Commercial mortgage pools	2,355,339	Unavailable
Money market	158,761	.422 years
Money market	7,509,782	Unavailable
Real estate	9,190,163	Unavailable
Other fixed income	37,803,218	Unavailable

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2007

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 Retirement System's investment policy limits investments in domestic fixed-income securities to not less than a B 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
Asset-backed securities	\$ 991,638	Aaa
Corporate bonds	1,799,525	Aaa
Corporate bonds	1,711,298	Aa
Corporate bonds	4,806,293	A
Corporate bonds	3,001,744	Baa
Corporate bonds	16,184,365	Unrated
U.S. government agency mortgage pools	8,436,985	Aaa
U.S. government obligations	6,649,918	Aaa
Commercial mortgage pools	9,190,163	Unrated
Mortgages	2,355,339	Unrated
Other fixed income	37,803,218	Unrated
Money markets and mutual funds	7,668,543	Unrated

Securities Lending

As permitted by state statutes and under the provisions of a securities lending authorization agreement, the Retirement System lends securities to broker-dealers and banks for collateral that will be returned for the same securities in the future. The Retirement 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, 2007, only United States currency was received as collateral.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2007

Note 3 - Deposits and Investments (Continued)

The Retirement 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 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. The average duration of such investment pool as of December 31, 2007 was 27 days. 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, 2007, the Retirement System had no credit risk exposure to borrowers. The collateral held and the fair market value of underlying securities on loan for the Retirement System as of December 31, 2007 was \$37,597,497 and \$36,710,696, respectively.

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, 2007, the Retirement System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 3,342,715
Reserved for retired employees	148,691,435

Required Supplemental Information

City of Pontiac Police and Fire Retirement System

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 (a/b)	Covered Payroll	UAAL as a Percentage of Covered Payroll
12/31/2000	\$ 239,667,248	\$ 191,594,863	\$ (48,072,385)	125.1	\$ 13,462,955	-
12/31/2001	245,966,812	203,166,600	(42,800,212)	121.1	13,710,467	-
12/31/2002	239,657,864	204,588,488	(35,069,376)	117.1	13,528,501	-
12/31/2003* #	244,770,438	216,553,276	(28,217,162)	113.0	15,308,134	-
12/31/2004 #	249,927,425	225,466,883	(24,460,542)	110.8	15,830,247	-
12/31/2005	253,702,503	229,779,819	(23,922,684)	110.4	13,758,914	-
12/31/2006	258,738,855	231,715,863	(27,022,992)	111.7	12,831,719	-

* Plan amended

Certain assumptions revised

City of Pontiac

Police and Fire Retirement System

Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2001	\$ 2,168,043	100.0
2002	1,809,736	100.0
2003	2,008,947	100.0
2004	2,141,247	100.0
2005	2,242,320	100.0
2006	2,324,011	100.0
2007	2,344,231	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2006, the latest actuarial valuation, follows:

Actuarial cost method	Individual entry age normal cost
Amortization method	Level percent of payroll
Remaining amortization period	20 years, open
Asset valuation method	Market value with five-year smoothing of changes in security prices
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	4.5% to 13.6%
*Includes inflation at	4.0%
Cost of living adjustments	2%