

City of Pontiac
Police and Fire Retirement System

Financial Report
with Required Supplemental Information
December 31, 2009

City of Pontiac Police and Fire Retirement System

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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 the City of Pontiac Police and Fire Retirement System (a component unit of the City of Pontiac, Michigan) as of December 31, 2009 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 the City of Pontiac Police and Fire Retirement System as of December 31, 2009 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 15, 2010

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:

	2009	2008
Total assets	\$ 258,820,688	\$ 230,023,981
Total liabilities:		
Amounts due broker under securities lending agreement	31,319,605	21,887,897
Other liabilities	278,510	329,443
Total liabilities	31,598,115	22,217,340
Assets held in trust for pension benefits	\$ 227,222,573	\$ 207,806,641
Net investment gain (loss)	\$ 33,977,599	\$ (62,183,716)
Net securities lending income	(5,317)	160,511
Contributions:		
Employee	264,814	277,987
Employer	1,230,190	1,829,115
Other - Miscellaneous and litigation revenue	135,732	196,580
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	\$ (14,975,806)	\$ (14,220,177)
Member refunds and withdrawals	(929,771)	(394,582)
Total benefits paid	(15,905,577)	(14,614,759)
Benefits paid in excess of contributions	\$ (17,400,581)	\$ (16,721,861)
General and administrative expenses	\$ (281,509)	\$ (280,983)
Net increase (decrease) in net assets held in trust	19,415,932	(74,615,265)

City of Pontiac Police and Fire Retirement System

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

The 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, 2009:

Domestic equities	41%
International equities and fixed income	14%
Domestic fixed income	33%
Real estate	8%
Timber	4%

Investment Results

In 2009, the markets came roaring back. The economic stimulus efforts and liquidity programs initiated by governments and central banks gave investors confidence that the financial crisis was under control and that the global economy would recover from the recession. The transition in equities occurred in March; after struggling in January and February, the markets posted strong gains over the next 10 months. The S&P 500 ended the year up 26.5 percent and the MSCI EAFE Index gained 31.8 percent. Corporate bonds also benefited from investors' appetite for risk; the Barclays Credit Index was up 16.1 percent and the Barclays High Yield Index was up 58.2 percent. Treasuries underperformed in 2009; the Barclays Government Index lost 2.2 percent. The total fund gained 16.5 percent for the year ended December 31, 2009.

The fund's total return must always be considered in a longer-term context. The fund's investment horizon is long term, corresponding to the long-term nature of the System's liabilities. Therefore, the board of trustees establishes an asset allocation policy to control risks and generate expected returns that will enable the fund to pay the benefits promised to members and retirees. 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

Police and Fire Retirement System

Statement of Plan Net Assets December 31, 2009

Assets

Cash (Note 3)	\$ 100,210
Cash and investments held as collateral for securities lending (Note 3)	31,235,409
Accrued interest and dividends receivable	334,870
Accounts receivable:	
Due from City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust	59,538
Due from City of Pontiac	195,694
Due from City of Pontiac General Employees' Retirement System	<u>2,742</u>
Total accounts receivable	257,974
Investments at fair value (Note 3):	
Money market and mutual funds	5,431,942
U.S. government agency notes and debentures	11,226,054
High yield bonds	5,966,776
Corporate and other bonds	19,436,404
Equities	120,802,835
Private equities	11,544,974
U.S. government mortgage-backed securities	8,984,749
Commercial mortgage pools	2,323,743
Asset-backed securities	2,258,275
Other fixed income	31,690,542
Other	<u>7,225,931</u>
Total investments at fair value	<u>226,892,225</u>
Total assets	258,820,688

Liabilities

Accounts payable and other liabilities	278,510
Amounts due to broker under securities lending agreement (Note 3)	<u>31,319,605</u>
Total liabilities	<u>31,598,115</u>

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

\$ 227,222,573

City of Pontiac

Police and Fire Retirement System

Statement of Changes in Plan Net Assets Year Ended December 31, 2009

Additions

Miscellaneous and litigation revenue	\$ 135,732
Securities lending income (loss):	
Interest and fees	126,119
Less borrower rebates	(47,240)
Less fair value decline on collateral held	<u>(84,196)</u>
Net securities lending loss	(5,317)
Contributions:	
Employee	264,814
Employer	<u>1,230,190</u>
Total contributions	1,495,004
Investment income:	
Interest and dividend income	3,457,431
Net appreciation in fair value	31,557,670
Investment advisor fees	<u>(1,037,502)</u>
Net investment income	<u>33,977,599</u>
Total additions	35,603,018

Deductions

Retirees' pension benefits and retirement incentives	(14,975,806)
Member refunds and withdrawals	(929,771)
Other expenses	(151,015)
Charges from the City - Administrative expenses	<u>(130,494)</u>
Total deductions	<u>(16,187,086)</u>

Net Increase in Net Assets Held in Trust for Pension Benefits	19,415,932
Net Assets Held in Trust for Pension Benefits - Beginning of year	<u>207,806,641</u>
Net Assets Held in Trust for Pension Benefits - End of year	<u><u>\$ 227,222,573</u></u>

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2009

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers the 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. Investments that do not have an established market value are reported based at estimated fair values. These estimates are determined using financial statements issued by the private equity companies in which such investments are held, adjusted by management as deemed appropriate based on known circumstances.

Note 2 - Plan Description and Contribution Information

At December 31, 2008, 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	390
Current employees:	
Fully vested	124
Nonvested	45
Total	169

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2009

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.

Annual Pension Costs - The annual contribution for the year ended December 31, 2009 was \$1,230,190. The annual contribution for the plan year was determined as part of actuarial valuations at December 31, 2006 and December 31, 2007, using the entry age normal cost method. Significant actuarial assumptions used include (a) a 7.5 percent investment rate of return, (b) projected salary increases of 4.0 percent per year, (c) additional salary increases of 0.5 percent to 9.6 percent per year based on merit and/or longevity, (d) cost-of-living adjustments of 2.0 percent per year, and (e) inflation of 4.0 percent. Both (a) and (b) are determined using techniques that smooth the effects of short-term volatility over a three-year period. The unfunded actuarial liability is being amortized at a level of percent of payroll on an open basis. The remaining amortization period is 20 years.

Per the actuarial report dated December 31, 2008, all assumptions have remained consistent.

Funded Status and Funding Progress - As of December 31, 2008, the most recent actuarial valuation date, the plan was 111.3 percent funded. The actuarial accrued liability for benefits was \$238,217,676 and the actuarial value of assets was \$265,251,339, resulting in actuarial accrued assets of \$27,033,662. The covered payroll (annual payroll for active employees covered by the plan) was \$9,749,807 and the ratio for the unfunded AAL to the covered payroll was 0 percent given the funded status.

The schedule of funding progress, presented as required supplemental information following the notes to the financial statements, presents multi-year trend information about whether the actuarial values of plan net assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2009

Note 2 - Plan Description and Contribution Information (Continued)

Three-year trend information as of December 31 is as follows:

	Fiscal Year Ended December 31		
	2007	2008	2009
Annual pension costs (APC)	\$ 2,344,231	\$ 1,829,115	\$ 1,230,190
Percentage of APC contributed	100%	100%	100%
Net pension obligation	\$ -	\$ -	\$ -

See Note 4 for disclosures of required reserves.

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 on the following page:

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2009

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 no bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. 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	\$ 1,865,332	.565 years
Asset-backed securities	392,943	Unavailable
Corporate and other bonds	13,082,228	7.54 years
Corporate and other bonds	16,658,008	Unavailable
U.S. governmental investments:		
Government bonds	4,013,049	5.06 years
Government bonds	2,916,888	7.80 years
Government agencies	4,296,117	1.44 years
Government mortgage-backed securities	4,708,210	2.84 years
Government mortgage-backed securities	4,276,539	Unavailable
Commercial mortgage pools	2,243,984	Unavailable
Money market	5,819,957	Unavailable
Other fixed income	31,690,542	Unavailable

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2009

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 AI 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	\$ 825,602	Aaa
Asset-backed securities	1,080,067	Aa
Asset-backed securities	352,606	A
Corporate bonds	1,486,940	Aa
Corporate bonds	5,839,698	A
Corporate bonds	6,493,268	Baa
Corporate bonds	15,920,330	Unrated
U.S. government agencies	4,296,117	Aaa
U.S. government bonds	4,015,388	Aaa
U.S. government bonds	2,914,549	Unrated
U.S. government mortgage-backed securities	8,984,749	Unrated
Commercial mortgage pools	2,243,984	Unrated
Other fixed income	31,690,542	Unrated
Money markets and mutual funds	5,819,957	Unrated
Other	79,759	Aaa

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, 2009, only United States currency was received as collateral.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2009

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, 2009 was 41 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, 2009, 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, 2009 was \$31,235,409 and \$30,380,586, 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, 2009, the Retirement System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 2,561,162
Reserved for retired employees	168,977,043

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
12/31/2003* #	\$ 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	-
12/31/2007	271,992,032	235,981,324	(36,010,708)	115.3	11,066,828	-
12/31/2008	265,251,339	238,217,676	(27,033,663)	111.3	9,749,807	-

* 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
2004	\$ 2,141,247	100.0
2005	2,242,320	100.0
2006	2,324,011	100.0
2007	2,344,231	100.0
2008	1,829,115	100.0
2009	1,230,190	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2009, the latest actuarial valuation, is as 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%-13.6%
Cost-of-living adjustments	- 2%
*Includes inflation at	- 4.0%