

City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust

Financial Report
December 31, 2010

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Contents

Report Letter	1
Management's Discussion and Analysis	2-4
Basic Financial Statements	
Statement of Trust Net Assets	5
Statement of Changes in Trust Net Assets	6
Notes to Financial Statements	7-13
Required Supplemental Information	14
Schedule of Analysis of Funding Progress	15
Schedule of Employer Contributions	16

Independent Auditor's Report

To the Board of Trustees
City of Pontiac Police and Fire Retiree Prefunded
Group Health and Insurance Trust

We have audited the accompanying statement of trust net assets of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (a component unit of the City of Pontiac, Michigan) as of December 31, 2010 and the related statement of changes in trust net assets for the year then ended. These financial statements are the responsibility of the board of trustees of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust. 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 Retiree Prefunded Group Health and Insurance Trust as of December 31, 2010 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 28, 2011

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

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.

Condensed Financial Information

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

	Fiscal Year Ended	
	December 31, 2010	December 31, 2009
Total assets	\$ 34,292,801	\$ 28,990,597
Total liabilities	3,508,142	2,288,135
Net trust assets	\$ 30,784,659	\$ 26,702,462
Net investment gain	\$ 4,813,711	\$ 5,955,748
Contributions - Employer	1,671,578	2,816,172
Contributions - Employee	10,423	-
Retiree health benefits paid	(2,385,475)	(2,572,834)
Contributions in excess of benefits paid	703,474	243,338
Ratio of contributions to benefits paid	70.5%	109.5%
General and administrative expenses	(28,040)	(26,228)
Net increase in trust net assets	4,082,197	6,172,858

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") exists to pay healthcare benefits to members retiring on or after August 22, 1996. Benefits currently being paid are significantly less than contributions currently being received. The excess of contributions over benefits paid will allow for additional funding to increase investment income to a level where the Trust will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

Asset Allocation

The Trust 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 Trust. The following is a summary of the asset allocation as of December 31, 2010:

Domestic equities	56%
Domestic fixed income	28%
Mutual funds and cash equivalents	15%
International equities	1%

Police and Fire Retiree Prefunded Group Health and Insurance Trust

Investment Results

2010 marked the second year of economic recovery from the great recession. Inflation was under control; however, commodity prices rose sharply during the second half of the year. Central banks maintained accommodative policies, holding interest rates down (at near historic low levels). The fixed-income market, as measured by the Barclays Aggregate Index, returned 6.5 percent for the year. The equity markets posted solid returns for the second consecutive year (albeit lower than 2009); the S&P 500 rose 15.1 percent, the Russell 2000 Index (a proxy for U.S. small-cap stocks) jumped 26.9 percent, and the MSCI EAFE Index (a proxy for international stocks) gained 7.8 percent. The total Trust gained 16.33 percent, net of related fees for the year ended December 31, 2010.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Management's Discussion and Analysis (Continued)

The total Trust's return must always be considered in a longer-term context. The Trust's investment horizon is long term, corresponding to the long-term nature of the Trust's liabilities. Therefore, the board of trustees establishes an asset allocation policy to control risks and generate expected returns that will enable the Trust 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 Trust over many years, not just one or two years.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Statement of Trust Net Assets December 31, 2010

Assets - Investments at fair value (Note 2)

Cash	\$ 92,625
Mutual funds	9,849,666
Equity mutual fund	4,976,052
Equities	18,042,556
Private equities	<u>1,331,902</u>
Total assets	34,292,801

Liabilities

Due to City of Pontiac	2,868,098
Due to City of Pontiac Police and Fire Retirement System	187,162
Accounts payable	32,885
Due to brokers	<u>419,997</u>
Total liabilities	<u>3,508,142</u>

Trust Net Assets

\$ 30,784,659

**City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust**

**Statement of Changes in Trust Net Assets
Year Ended December 31, 2010**

Additions

Contributions:

Employee	\$ 10,423
Employer	<u>1,671,578</u>

Total contributions 1,682,001

Investment income:

Interest and dividend income	741,878
Net increase in fair value of investments	4,189,502
Investment advisor fees	<u>(117,669)</u>

Net investment income 4,813,711

Total additions 6,495,712

Deductions

Retirees' health benefits	(2,385,475)
Other expenses	<u>(28,040)</u>

Total deductions (2,413,515)

Net Increase in Trust Net Assets 4,082,197

Trust Net Assets - January 1, 2010 26,702,462

Trust Net Assets - December 31, 2010 \$ 30,784,659

City of Pontiac

Police and Fire Retiree Prefunded Group Health and Insurance Trust

**Notes to Financial Statements
December 31, 2010**

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") has established an irrevocable prefunded group health and insurance trust fund for health, optical, dental, and life insurance benefits for retirees who are members of the Police and Fire Retirement System of the City of Pontiac and who retired on or after August 22, 1996. City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") was created as an Internal Revenue Code 501(c)(9) Trust (VEBA). The Police and Fire Retirement System (the "Retirement System") performs the Trust's accounting function.

Reporting Entity - The Trust is a component unit of the City of Pontiac, Michigan. The Trust does not hold securities of or make loans to the City.

Plan Sponsor Financial Condition - The City of Pontiac (the plan sponsor) is experiencing significant financial difficulty. The City is currently in receivership under Michigan Public Act 4 of 2011. The result is that the State has appointed an Emergency Manager to control the finances of the City. Uncertainty exists regarding the City's ability to continue to make contributions to the plan. Contributions that were scheduled to be made to the plan for the year ended December 31, 2010 in the amount of \$2,104,382 were not remitted to the plan by the City and the City stated that they no longer intended to make these contributions. These amounts are not reflected in the financial statements. As a result, we have reported the funded status of the plan using the actuary's 5 percent alternate investment return assumption as opposed to the 7.5 percent assumption that has historically been used.

Basis of Accounting - The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust'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. Insurance costs are recognized when due and payable in accordance with the terms of the Trust.

Investments - Investments are reported at fair value. Money market funds and mutual fund investments are valued at net asset value. Dividend income is recorded on the ex-dividend date. Income from other investments is recorded as earned on an accrual basis. In accordance with the policy of stating investments at fair value, net unrealized appreciation or depreciation for the year is reflected in the statement of changes in trust net assets.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

**Notes to Financial Statements
December 31, 2010**

Note 1 - Summary of Significant Accounting Policies (Continued)

Federal Income Taxes - The Trust is exempt from income tax under Section 501(a).

Note 2 - 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 local unit 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.

A retiree healthcare fund is also authorized by Michigan Public Act 314 of 1965 (the "Act"), as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The Trust 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 mutual or commingled funds, but not the remainder of state statutory authority as listed above. The Trust's deposits and investment policies are in accordance with statutory authority.

**City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust**

**Notes to Financial Statements
December 31, 2010**

Note 2 - Investments (Continued)

The Trust's cash and investments are subject to several types of risk, which are examined in more detail below:

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 Trust's investment policy does not restrict investment maturities. At year end, the average maturities of investments are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Weighted Average Maturity</u>
Corporate:		
Asset backed	\$ 282,548	4.25 years
Bonds	2,664,233	5.8 years
Collateralized mortgage obligations	1,297,252	31.48 years
Foreign bonds	528,885	6.84 years
U.S. government :		
Collateralized mortgage obligations	99,545	9.41 years
Mortgage backed	2,380,071	27.81 years
Other	424,881	20.08 years
Treasuries, notes, and bonds	1,791,616	1.83 years

City of Pontiac

Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements
December 31, 2010

Note 2 - Investments (Continued)

Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Trust has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Corporate:			S&P
Asset backed	\$ 99,850	AAA	S&P
Asset backed	182,697	Not rated	N/A
Bonds	183,935	AA	S&P
Bonds	832,221	A	S&P
Bonds	1,569,316	BBB	S&P
Bonds	78,762	BB	S&P
Collateralized mortgage obligations	192,204	AAA	S&P
Collateralized mortgage obligations	241,055	AA	S&P
Collateralized mortgage obligations	764,148	A	S&P
Collateralized mortgage obligations	99,845	Not rated	N/A
Foreign bonds	113,135	AA	S&P
Foreign bonds	224,021	A	S&P
Foreign bonds	191,729	BBB	S&P
U.S. government :			S&P
Collateralized mortgage obligations	99,545	Not rated	N/A
Mortgage backed	2,380,071	Not rated	N/A
Other	424,881	Not rated	N/A
Treasuries, notes, and bonds	1,791,616	AAA	S&P

**City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust**

**Notes to Financial Statements
December 31, 2010**

Note 2 - Investments (Continued)

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 Trust places no limit on the amount of international stock funds. The following securities contained within the international stock fund are subject to foreign currency risk:

	Fair Market Value
European euro	\$ 2,293,957
Japanese yen	686,694
British pound	701,622
Latin American peso	308,515
Other	696,646

Note 3 - Trust Contribution Information

The Trust is primarily funded by employer contributions. The trustees voted to implement funding at the actuarial recommended rate beginning July 1, 2006. Effective July 1, 2010, one of the three bargaining units covered by this Trust are required to contribute 1.0 percent of covered wages; however, the other two bargaining units along with the covered non-union members continue to have no employee contribution requirements. Employer contributions to the plan for the City's fiscal year ended June 30, 2010 were determined as part of the December 31, 2007 actuarial valuation, which recommended an employer contribution of 35.22 percent of police and fire wages. The City funded at this rate for the fiscal year ended June 30, 2010. At July 1, 2010, the contribution rate increased to 42.06 percent; however the scheduled contributions after July 1, 2010 were not paid to the Trust by the City.

Note 4 - Trustees

Two trustees of City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust as of December 31, 2010 were elected by the membership, two sit by virtue of their position, and one is appointed by the other trustees.

**City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust**

**Notes to Financial Statements
December 31, 2010**

Note 5 - Membership Data

At December 31, 2008, the date of the most recent actuarial valuation, membership data consisted of the following:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	<u>156</u>
Current employees:	
Fully vested	135
Nonvested	<u>34</u>
Total current employees	<u>169</u>

Note 6 - Postemployment Benefits

Plan Description - The City provides retiree healthcare benefits to eligible employees and their spouses through the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust. This is a single-employer benefit plan administered by the City of Pontiac Police and Fire Retirement System.

The plan's financial statements are also included in the City of Pontiac's financial report and can be obtained by writing to 47450 Woodward Ave., Pontiac, MI 48342.

Funding Policy - The City is required by ordinance to contribute on a percentage of covered payroll which the trustees have deemed to be based on actuarial recommended amounts. During the City's fiscal year ended June 30, 2010, the City contributed \$3,158,681 into the Trust, which is reported in the City's financial statements as a pension and other employee benefit trust fund.

The funding progress of the plan as of December 31, 2008 (the most recent valuation date, based on the 5 percent alternate investment return assumption) is as follows:

Actuarial value of assets	\$ 31,405,001
Actuarial accrued liability (AAL)	\$ 113,221,193
Unfunded AAL (UAAL)	\$ 81,816,192
Funded ratio	27.74%
Annual covered payroll	\$ 9,749,807
Ratio of UAAL to covered payroll	839.16%

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

**Notes to Financial Statements
December 31, 2010**

Note 6 - Postemployment Benefits (Continued)

Actuarial Methods and Assumptions - Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend.

Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The required schedule of funding progress immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2008 actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5 percent investment rate of return as well as an alternate 5 percent investment rate of return compounded annually (net of administrative expenses). The financial statements reflect the use of the alternate 5 percent investment rate of return, which consists of a real rate of return of 0.5 percent per year plus a long-term rate of inflation of 4.5 percent per year. The valuation did not include specific assumptions related to healthcare cost increases. The actuarial value of assets is set to equal fair market value. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2008 was 30 years.

Required Supplemental Information

**City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust**

**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
12/31/06	\$ 25,534,993	\$ 79,788,465	\$ 54,253,472	32.0	\$ 12,831,719	422.81%
12/31/07	30,185,216	73,171,572	42,986,356	41.3	11,066,828	388.43%
12/31/08*	31,405,001	113,221,193	81,816,192	27.7	9,749,807	839.16%

* 12/31/08 actuarial valuation information was derived from the actuary's 5 percent alternate return assumption. Note: Actuary valuation reports obtained for the Trust for the fiscal years ended December 31, 2005 and 2004 do not disclose the actuarial accrued liability. The above actuarial valuation dates reflect the most recent available

**City of Pontiac
Police and Fire Retiree Prefunded
Group Health and Insurance Trust**

**Required Supplemental Information
Schedule of Employer Contributions**

Year Ended <u>June 30</u>	<u>Annual Required Contribution</u>	<u>Amount Contributed *</u>
2009	\$ 5,594,865	\$ 2,678,324
2010	4,553,185	3,158,681

* GASB Statement No. 45 was adopted by the City for the City's fiscal year ended June 30, 2009. As such, amount contributed corresponds to the City's fiscal year end (pursuant to GASB Statement No. 45) as opposed to the plan's calendar year end.