

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

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**Financial Report**  
**with Required Supplemental Information**  
**December 31, 2011**

# **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 (the "System") (a component unit of the City of Pontiac, Michigan) as of December 31, 2011 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, 2011 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, retirement system schedules of funding progress, and the schedule of employer contributions, as identified in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplemental information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Plante & Moran, PLLC*

September 20, 2012

# 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:

	2011	2010
Total assets	\$ 396,300,940	\$ 499,037,719
Total liabilities:		
Amounts due broker under securities lending agreement	-	78,272,910
Other liabilities	1,001,347	885,575
Total liabilities	1,001,347	79,158,485
Net assets held in trust for pension benefits	<b>\$ 395,299,593</b>	<b>\$ 419,879,234</b>
Net investment (loss) income	\$ (3,085,494)	\$ 54,659,564
Net securities lending income	158,866	133,370
Employer contributions	23,083	-
Other - Miscellaneous and litigation revenue	81,465	138,373
Retiree pension and annuity benefits	(21,037,340)	(20,624,034)
General and administrative expenses	(720,221)	(675,619)
Net increase in net assets held in trust	<b>\$ (24,579,641)</b>	<b>\$ 33,631,654</b>

# 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 that 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 (excluding the collateral pool) as of December 31, 2011:

Domestic equities	58%
Domestic fixed income	21%
International equities and fixed income	8%
Basket Clause Category Securities	9%
Cash	4%

Subsequent to year end, the board of trustees adopted a revised asset allocation policy consistent with the System's return objectives and risk parameters. The revised targeted asset allocation is as follows:

Equity	55-70%
Fixed income	24-36%
Real estate	3-7%
Private equity	3-7%
Cash	0-5%

### Investment Results

The sovereign debt crisis in Europe and disappointing economic growth globally dominated the capital markets during 2011. Central banks maintained very accommodative policies and interest rates tended to decline around the world. Core inflation in the U.S. was near long-term targets at 3.0 percent while commodity prices tended to fall. The decline in interest rates drove the fixed-income markets higher; the Barclays U.S. Aggregate returned 7.8 percent for the year. The equities markets were volatile.

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

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

### **Investment Results (Continued)**

After posting nice gains in the first quarter, stocks suffered a significant sell off over the summer; a recovery late in the year helped offset those losses. The Standard & Poor's 500 rose 2.1 percent, the Russell 2000 Index (a proxy for U.S. small cap stocks) declined 4.2 percent, and the MCSI EAFE Index (a proxy for international stocks) dropped 12.1 percent. Using the time weighted return computation method, the total fund lost 0.02 percent for the year ended December 31, 2011.

The total fund's 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.

### **Plan Sponsor Financial Condition/Plan Update**

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. The plan is currently overfunded and no employer contributions are required at this time. Should a contribution be required in the future, there is uncertainty regarding the City's ability and intent to make contributions to the plan.

Additionally, as a result of various changes at the City occurring under the Emergency Manager during 2011, a partial termination of the pension plan for general employees was deemed to have occurred. This specifically resulted from the termination of various active employee positions at the City under executive orders issued by the Emergency Manager. The impact of changes in membership composition and the funded status of the pension plans are unknown at this time; however, due to the System's funded status, the impact is not expected to be significant.

# City of Pontiac

## General Employees' Retirement System

### Statement of Plan Net Assets December 31, 2011

#### Assets

Cash (Note 3)	\$ 5,091
Accrued interest and dividends receivable	1,723,822
Accounts receivable - Due from GERS VEBA	21,420
Investments at fair value (Note 3):	
Money market funds	17,522,050
Government agency notes and debentures	7,534,139
High-yield bonds	24,981,386
Corporate and other bonds	38,034,679
Equities	261,663,292
Private equities	6,567,644
U.S. government mortgage-backed securities	26,021,757
Commercial mortgage pools	4,688,185
Asset-backed securities	6,715,801
Other	821,674
Total investments	<u>394,550,607</u>
Total assets	<u>396,300,940</u>

#### Liabilities

Due to City of Pontiac	286,505
Due to City of Pontiac Police and Fire Retirement System	743
Accounts payable	714,099
Total liabilities	<u>1,001,347</u>

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

**\$ 395,299,593**

# City of Pontiac

## General Employees' Retirement System

### Statement of Changes in Plan Net Assets Year Ended December 31, 2011

#### Additions

Contributions (reinstated members)	\$ 23,083
Miscellaneous and litigation revenue	81,465
Investment income (loss):	
Interest and dividend income	9,999,869
Net depreciation in fair value	(10,390,964)
Investment advisor fees	(2,694,399)
Net investment loss	(3,085,494)
Securities lending income:	
Interest and fees	237,776
Less borrower rebates and bank fees	(78,910)
Net securities lending income	158,866
Total additions - Net	(2,822,080)

#### Deductions

Retirees' pension benefits and retirement incentives	(21,037,340)
Other expenses	(433,714)
Charges from the City of Pontiac - Administrative expenses	(286,507)
Total deductions	(21,757,561)

<b>Net Decrease in Net Assets Held in Trust for Pension Benefits</b>	(24,579,641)
<b>Net Assets Held in Trust for Pension Benefits - January 1, 2011</b>	419,879,234
<b>Net Assets Held in Trust for Pension Benefits - December 31, 2011</b>	<b><u>\$ 395,299,593</u></b>

# **City of Pontiac**

## **General Employees' Retirement System**

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**Notes to Financial Statements**  
**December 31, 2011**

### **Note 1 - Summary of Significant Accounting Policies**

The City of Pontiac (the "City") sponsors and administers the City of Pontiac 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.

**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. The plan is currently overfunded and no employer contributions are required at this time. Should a contribution be required in the future, there is uncertainty regarding the City's ability and intent to make contributions to the plan.

**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. 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.

# City of Pontiac

## General Employees' Retirement System

### Notes to Financial Statements December 31, 2011

#### Note 2 - Plan Description and Contribution Information

At December 31, 2010, 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	1,299
Current employees:	
Fully vested	111
Nonvested	96
Total current employees	207

**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 amounts, 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.

**Partial Termination** - During 2011, a partial termination of the pension plan for general employees was deemed to have occurred. This resulted from the termination of various active employee positions at the City under executive orders issued by the Emergency Manager. The impact of membership composition and the funded status of the pension plans are unknown at this time; however due to the funded status of the plan, the impact is not anticipated to be significant.

**Contributions** - Plan members are not required to contribute. The City is required to contribute at an actuarially determined rate. In accordance with the actuary recommendation, the City did not make a contribution to the plan in the current year. Administrative costs are financed through investment earnings.

# City of Pontiac

## General Employees' Retirement System

### Notes to Financial Statements December 31, 2011

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

**Annual Pension Costs** - The annual contribution for the year ended December 31, 2011 was \$0. The annual contribution for the plan year was determined as part of actuarial valuations at December 31, 2008 using the entry age actuarial cost method. Significant actuarial assumptions used include (a) a 7.5 percent investment rate of return, (b) projected salary increases of 4.5 percent per year, (c) additional salary increases of 1.1 percent to 4.9 percent per year based on merit and/or longevity, (d) cost of living adjustments ranging from 2.0 percent to 2.5 percent per year, and (e) inflation of 4.5 percent. Both (a) and (b) are determined by using techniques that smooth the effects of short-term volatility over a five-year period. The unfunded actuarial liability is being amortized as a level of percent of payroll on an open basis. The remaining amortization period is 30 years.

Per the actuarial report dated December 31, 2009, all assumptions have remained consistent.

**Funded Status and Funding Progress** - As of December 31, 2010, the most recent actuarial valuation date, the plan was 157.4 percent funded. The actuarial accrued liability for benefits was \$253,866,554 and the actuarial value of assets was \$399,573,669, resulting in actuarial accrued assets of \$145,707,115. The covered payroll (annual payroll for active employees covered by the plan) was \$9,493,229 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.

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

	Fiscal Year Ended December 31		
	2009	2010	2011
Annual pension costs (APC)	\$ -	\$ -	\$ -
Percentage of APC contributed	100%	100%	100%
Net pension obligation	\$ -	\$ -	\$ -

# City of Pontiac

## General Employees' Retirement System

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### Notes to Financial Statements December 31, 2011

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

**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, 2011, the System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 1,796,755
Reserved for retired employees	204,034,249

#### 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.

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:

# City of Pontiac

## General Employees' Retirement System

### Notes to Financial Statements December 31, 2011

#### 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 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 no bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The System continues to evaluate 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	Effective Duration
Asset-backed securities	\$ 6,715,801	1.81 years
Commercial mortgage pools	4,688,185	2.76 years
Corporate and other bonds	63,016,065	3.87 years
U.S. governmental investments:		
Government bonds	5,508,679	11.75 years
Government issued commercial mortgage backed	993,855	3.70 years
Government mortgage-backed securities	27,425,481	15.25 years
Other government agencies	816,821	5.82 years
Nongovernment-backed CMOs	239,819	.89 years
Nongovernment-backed CMOs	634,978	Unavailable
Municipal/Provincial bonds	1,144,478	6.12 years
Municipal/Provincial bonds	64,160	Unavailable
Short-term investment funds	15,198,170	Unavailable

# City of Pontiac

## General Employees' Retirement System

### Notes to Financial Statements December 31, 2011

#### 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 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/S&P Rating
Asset-backed securities	\$ 4,306,559	Aaa
Asset-backed securities	576,665	Aa
Asset-backed securities	902,276	A
Asset-backed securities	930,301	Unrated
Commercial mortgage-backed securities	3,431,019	Aaa
Commercial mortgage-backed securities	1,257,166	Unrated
Corporate bonds	910,575	Aaa
Corporate bonds	6,488,245	Aa
Corporate bonds	14,720,377	A
Corporate bonds	15,372,965	Baa
Corporate bonds	1,086,888	Ba
Corporate bonds	16,828,784	B
Corporate bonds	6,615,040	Caa
Corporate bonds	993,191	Unrated
Governmental agencies	816,821	A
U.S. governmental agency	2,397,579	Aaa
U.S. governmental agency mortgage-backed securities	85,589	Unrated
Nongovernment-backed CMOs	31,451	A
Nongovernment-backed CMOs	843,346	Unrated
Municipal/Provincial bonds	64,160	Aaa
Municipal/Provincial bonds	704,822	Aa
Municipal/Provincial bonds	439,657	Unrated
Short-term investment funds	15,198,170	Unrated

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

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**Notes to Financial Statements  
December 31, 2011**

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

### **Securities Lending**

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, 2011, there was no currency 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 Systems' board authorized the termination of participation in the securities lending program on November 30, 2011. As of December 31, 2011, the System did not have any securities on loan.

## **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
12/31/05	\$ 391,409,757	\$ 260,103,260	\$ (131,306,497)	150	\$ 16,751,815	-
12/31/06	409,983,490	266,457,429	(143,526,061)	153.9	14,996,753	-
12/31/07	433,028,186	257,940,349	(175,087,837)	167.9	13,559,473	-
12/31/08	416,678,512	261,497,756	(155,180,756)	159.3	14,414,481	-
12/31/09	405,193,572	255,720,207	(149,473,365)	158.5	12,553,146	-
12/31/10	399,573,669	253,866,554	(145,707,115)	157.4	9,493,229	-

# City of Pontiac General Employees' Retirement System

## Required Supplemental Information Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2006	\$ 15,695	100.0
2007		100.0
2008	-	100.0
2009	-	100.0
2010	-	100.0
2011	-	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2010, the latest actuarial valuation, is as follows:

Asset valuation method	Market value with five-year smoothing of gains and losses
Actuarial assumptions:	
Investment rate of return*	7.5 percent
Projected salary increases*	5.6 to 9.4 percent
Cost of living adjustments	2 percent (2.5 percent Court/MAPE) of original amount, subject to a maximum that varies by group
*Includes inflation at	4.5 percent