

City of Pontiac
Police and Fire Retirement System

Financial Report
with Required Supplemental Information
December 31, 2011

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City of Pontiac
Police and Fire Retirement System

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December 31, 2011

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, 2011 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, 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 which, 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

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:

	2011	2010
Total assets	\$ 218,734,724	\$ 272,069,046
Total liabilities:		
Amounts due broker under securities lending agreement	-	33,289,538
Other liabilities	281,500	220,480
Total liabilities	281,500	33,510,018
Assets held in trust for pension benefits	<u>\$ 218,453,224</u>	<u>\$ 238,559,028</u>
Net investment (loss) gain	\$ (1,771,969)	\$ 27,633,257
Net securities lending income	41,271	50,851
Contributions:		
Employee	786,538	352,233
Employer	-	438,593
Other - Miscellaneous and litigation revenue	41,513	398,431
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	\$ (18,051,695)	\$ (16,885,689)
Member refunds and withdrawals	(711,290)	(280,755)
Total benefits paid	<u>\$ (18,762,985)</u>	<u>\$ (17,166,444)</u>
Benefits paid in excess of contributions	<u>\$ 17,976,447</u>	<u>\$ 16,375,618</u>
General and administrative expenses	\$ (440,172)	\$ (370,466)
Net (decrease) increase in net assets held in trust	(20,105,804)	11,336,455

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, 2011:

Domestic equities	40%
Domestic fixed income	34%
International equities and fixed income	12%
Real estate	7%
Basket Clause Category Securities	3%
Cash	3%

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. 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. The total fund gained 0.21 percent for the year ended December 31, 2011.

City of Pontiac Police and Fire Retirement System

Management's Discussion and Analysis (Continued)

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

Plan Contributions

Given the financial condition of the plan sponsor (discussed at length in Note 1), contributions were not made into the plan during both the current and prior years and thus have not been reflected in the financial statements. It is unknown at this time whether these contributions as well as contribution requirements for future years will be forthcoming.

City of Pontiac

Police and Fire Retirement System

Statement of Plan Net Assets December 31, 2011

Assets

Cash (Note 3)	\$ 5,391
Accrued interest and dividends receivable	370,349
Accounts receivable:	
Due from City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust	135,318
Due from City of Pontiac General Employees' Retirement System	<u>743</u>
Total accounts receivable	136,061
Investments at fair value (Note 3):	
Money market and mutual funds	7,120,605
U.S. government agency notes and debentures	1,880,020
High-yield bonds	4,679,966
Corporate and other bonds	35,194,158
Equities	115,116,089
Private equities	6,779,731
Real estate	8,637,839
U.S. government mortgage-backed securities	13,778,440
Commercial mortgage pools	353,183
Asset-backed securities	67,197
Other fixed income	<u>24,615,695</u>
Total investments at fair value	<u>218,222,923</u>
Total assets	218,734,724
Liabilities - Accounts payable and other liabilities	<u>281,500</u>
Net Assets Held in Trust for Pension Benefits (a schedule of funding progress is presented in the required supplemental information)	<u><u>\$ 218,453,224</u></u>

City of Pontiac

Police and Fire Retirement System

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

Additions

Miscellaneous and litigation revenue	\$ 41,513
Securities lending income:	
Interest and fees	94,232
Less borrower rebates	<u>(52,961)</u>
Net securities lending income	41,271
Employee contributions	786,538
Investment income:	
Interest and dividend income	3,228,551
Net depreciation in fair value	(4,153,149)
Investment advisor fees	<u>(847,371)</u>
Net investment loss	<u>(1,771,969)</u>
Total additions - Net	(902,647)

Deductions

Retirees' pension benefits and retirement incentives	(18,051,695)
Member refunds and withdrawals	(711,290)
Other expenses	(317,383)
Charges from the City - Administrative expenses	<u>(122,789)</u>
Total deductions	<u>(19,203,157)</u>
Net Decrease in Net Assets Held in Trust for Pension Benefits	(20,105,804)
Net Assets Held in Trust for Pension Benefits - January 1, 2011	<u>238,559,028</u>
Net Assets Held in Trust for Pension Benefits - December 31, 2011	<u>\$ 218,453,224</u>

City of Pontiac

Police and Fire Retirement System

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 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.

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 Pension and Healthcare Trust Plans. Contributions that were scheduled to be made for the years ended December 31, 2011 and 2010 in the amount of approximately \$900,000 and \$450,000, respectively, were not remitted to the plan by the City.

In 2011, the Retirement System filed a lawsuit against the plan sponsor to demand payment. As a result, a judgment levy was placed on the tax roll in order to satisfy these outstanding contributions. Subsequently, an injunction was filed to cease the tax collection process; the taxes collected under this judgment levy, which were previously held in escrow by the City, have now been refunded to the taxpayers. As the legal proceedings are still pending, with significant uncertainty existing as to the anticipated outcome (and thus ultimate collectibility of these contributions), these contribution amounts have not been reflected in the Retirement System's 2011 or 2010 financial statements.

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.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements December 31, 2011

Note 1 - Summary of Significant Accounting Policies (Continued)

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

Membership consisted of the following:

	March 1, 2012	December 31	
		2011	2010
Retirees and beneficiaries currently receiving benefits	455	442	421
Terminated employees entitled to benefits but not yet receiving them	161	72	23
Current employees:			
Fire	0	58	70
Police	0	0	51
Total current employees *	0	58	121

*As of March 1, 2012, there were no active employees.

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.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements December 31, 2011

Note 2 - Plan Description and Contribution Information (Continued)

Partial Termination - During 2011, a partial termination of the pension plan for police and fire employees was deemed to have occurred when the City contracted with Oakland County Sheriff for policing services. This resulted from the termination of active employee positions at the City under Executive Orders issued by the Emergency Manager. The actuarial valuation as of December 31, 2011 reflects the transfer of employees from active status to vested inactive status as a result of the partial termination. Likewise, a supplemental actuarial valuation was performed as of March 1, 2012 to reflect the change in status of the fire employees from active members to vested inactive members. As of March 1, 2012, the City contracted with Waterford Township to provide fire services. This valuation indicates that the actuarial accrued liabilities decreased by approximately \$2.54 million, resulting in a decrease in unfunded actuarial accrued liabilities from \$4.51 million to \$1.97 million. Plan membership has decreased from 121 as of December 31, 2010 to 58 as of December 31, 2011 and ultimately to zero as of March 1, 2012.

Closing of Plan - Given that effective March 2012, there are no current active participants, the plan is deemed to be closed. As a result, the Retirement System's actuary is expressing the annual required contribution as a level dollar amount amortized on a closed basis rather than as a level percent of payroll. Upon the closing of the plan, the required employer contribution for the year beginning July 1, 2013 was recomputed from \$1,449,540 to \$901,797.

Contributions - Plan members are required to contribute 2.5 percent of their annual salaries. In accordance with the State Constitution, the City is required to contribute at an actuarially determined rate. Administrative costs are financed through investment earnings.

Annual Pension Costs - The annual required contribution for the year ended December 31, 2011 was \$931,311; however, as discussed in Note 1, actual contributions to the plan during this period were \$0. The annual contribution for the plan year was determined as part of actuarial valuations at December 31, 2008 and 2009, 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 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. In these valuations, 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.

**City of Pontiac
Police and Fire Retirement System**

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

Note 2 - Plan Description and Contribution Information (Continued)

Funded Status and Funding Progress - Per the actuarial reports dated December 31, 2010, 2011, and March 1, 2012, all assumptions have remained consistent, except that in the December 31, 2011 and March 1, 2012 valuations, the unfunded actuarial liability is being amortized using level dollars instead of level percentage of payroll.

As of December 31, 2011 and March 1, 2012, the two most recent full actuarial valuation dates, the plan was 98 and 97 percent funded, respectively. At December 31, 2011, the actuarial accrued liability for benefits was \$245,699,778 and the actuarial value of assets was \$239,781,316, resulting in an unfunded actuarial accrued liability of \$5,918,462. At March 1, 2012, the actuarial accrued liability for benefits was \$248,335,145 and the actuarial value of assets was \$239,781,316, resulting in an unfunded actuarial accrued liability of \$8,553,829. The covered payroll (annual payroll for active employees covered by the plan) was \$3,141,280 for the year ended December 31, 2011 and zero from January 1 through March 1, 2012 as there are no active members remaining in the plan.

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)	\$ 1,230,190	\$ 887,134	\$ 931,311
Percentage of APC contributed	100%	49%	- %
Net pension obligation	\$ -	\$ -	\$ -

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

Reserved for employee contributions	\$ 2,181,852
Reserved for retired employees	202,611,057

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2011

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, 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 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	\$ 67,197	2.46 years
Corporate and other bonds	18,521,590	5.60 years
Corporate and other bonds	16,672,568	1.89 years
U.S. governmental investments:		
Government Agencies	1,377,188	4.01 years
Government Bonds	502,832	0.13 years
Government mortgage-backed securities	13,778,440	1.25 years
Nongovernment-backed CMOs	5,955	.01 years
Other fixed-income pool	24,615,695	Unavailable

City of Pontiac

Police and Fire 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 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	S&P 500 Rating
Asset-backed securities	\$ 67,197	B
Corporate bonds	1,682,740	AA
Corporate bonds	13,006,952	A
Corporate bonds	3,831,897	Bbb
Corporate bonds	16,672,568	Unrated
Other fixed-income pool	24,615,695	Unrated
Short Term Investment Funds	7,118,906	AI +
Government Agencies	1,377,188	AA

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, 2011, only United States currency was received as collateral.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2011

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 Systems' board authorized the termination of participation in the securities lending program on December 1, 2011. As of December 31, 2011, the Retirement System did not have any securities on loan.

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
12/31/2005	\$ 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	-
12/31/2009	259,240,616	243,283,874	(15,956,742)	106.6	7,405,796	-
12/31/2010	253,878,331	244,915,039	(8,963,292)	103.7	6,667,866	-
12/31/2011	239,781,316	245,699,778	5,918,462	97.6	3,141,128	188.4%
3/1/2012*	239,781,316	248,335,145	8,553,829	96.6	-	n/a

* March 1, 2012 valuation uses the funding value of assets as of December 31, 2011.

City of Pontiac

Police and Fire Retirement System

Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2007	\$ 2,344,231	100.0
2008	1,829,115	100.0
2009	1,230,190	100.0
2010	887,134	49.0
2011	931,311	0.0
2012	901,797	n/a*

*Contribution requirements are not yet due

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of March 1, 2012, the latest full actuarial valuation, is as follows:

Actuarial cost method	- Individual entry age normal cost
Amortization method	- Level dollar, closed
Remaining amortization period	- 20 years
Asset valuation method	- Market value with five-year smoothing of gains and losses
Actuarial assumptions:	
Investment rate of return*	- 7.5%
Projected salary increases*	- 4.5%-11.0%
Cost of living adjustments	- 2%
*Includes inflation at	- 4.0%