

City of Pontiac Police and Fire Retirement System

**Financial Report
with Supplemental Information
December 31, 2012**

City of Pontiac Police and Fire Retirement System

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Independent Auditor's Report

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

We have audited the accompanying statement of plan net position and the related statement of changes in plan net position of the City of Pontiac Police and Fire Retirement System (a component unit of the City of Pontiac, Michigan) as of and for the year ended December 31, 2012 and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective plan net position of the City of Pontiac Police and Fire Retirement System as of December 31, 2012 and the respective changes in plan net position thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matters

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the pension system schedules of funding progress and 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

June 26, 2013

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:

	2012	2011
Total assets	\$ 226,953,473	\$ 218,734,724
Total liabilities	14,962	281,500
Assets held in trust for pension benefits	\$ 226,938,511	\$ 218,453,224
Net investment gain (loss)	\$ 26,078,658	\$ (1,771,969)
Net securities lending income	-	41,271
Contributions:		
Employee	44,842	786,538
Employer	2,176,867	-
Other - Miscellaneous and litigation revenue	67,072	41,513
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	(19,187,531)	(18,051,695)
Member refunds and withdrawals	(430,850)	(711,290)
Total benefits paid	\$ (19,618,381)	\$ (18,762,985)
Benefits paid in excess of contributions	\$ 17,396,672	\$ 17,976,447
General and administrative expenses	\$ (263,771)	\$ (440,172)
Net increase (decrease) in net assets held in trust	8,485,287	(20,105,804)

City of Pontiac Police and Fire Retirement System

Management's Discussion and Analysis (Continued)

Plan Contributions

Employer contributions were \$0 and \$2,176,867 in 2011 and 2012, respectively. As discussed in Note 1, in 2013, a settlement agreement was reached between the System and the plan sponsor whereby the City of Pontiac remitted payment for past due contributions for 2010 and 2011 in the amounts of \$448,541 and \$826,524, respectively. These amounts, which had previously been omitted from the financial statements, have been recognized as of December 31, 2012. Contributions for 2012 in the amount of \$901,797 were also remitted and included in the financial statements.

Employee contributions were \$786,538 and \$44,842 in 2011 and 2012, respectively. Prior to the plan closure effective March 1, 2012, active system employees were required to contribute 2.5 percent of applicable wages. As of March 1, 2012, there were no active plan members, resulting in minimal employee contributions for the year ended December 31, 2012.

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, 2012:

Domestic equities	41.6%
Domestic fixed income	29.8%
International equities and fixed income	13.7%
Real estate	7.7%
Basket clause category securities	3.5%
Cash	3.7%

City of Pontiac Police and Fire Retirement System

Management's Discussion and Analysis (Continued)

Investment Results

The European Central Bank announced a program to save the Eurozone, and the U.S. Federal Reserve introduced Quantitative Easing III; this intervention by the central banks provided stability to the capital markets and investors with confidence. Core inflation in the U.S. was below long-term targets at 1.7 percent and commodity prices tended to fall. Interest rates ended the year nearly unchanged from January 1. The fixed-income market posted modest gains as spreads contracted; the Barclays U.S. Aggregated returned 4.2 percent for the year. The ECB's "Save the Euro" comments drove the equity markets higher over the summer, producing a significant portion of the year's gains. The Standard & Poor's 500 returned 16.1 percent, the Russell 2000 (a proxy for U.S. small cap stocks) rose 16.3 percent, and the MSCI EAFE Index (a proxy for international stocks) advanced 17.3 percent. The total fund gained 12.00 percent for the year ended December 31, 2012 (measured using the time weighted return on each component of the Total Fund).

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.

City of Pontiac Police and Fire Retirement System

Statement of Plan Net Position December 31, 2012

Assets

Cash	\$	390
Investments at fair value (Note 4):		
U.S. government mortgage-backed securities		17,909,534
U.S. government agency notes and debentures		3,870,214
Partnerships - Global bond fund		9,651,835
Partnerships - Real estate		7,740,760
Partnerships - High yield		5,413,065
Equities		124,290,963
Short-term investment funds		8,397,463
Real estate		9,300,633
Corporate and other bonds		20,093,458
Bond index fund		17,695,993
Accounts receivable:		
Due from City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust		86,698
Contributions receivable		2,176,862
Accrued interest and dividends receivable		325,605
		<hr/>
Total assets		226,953,473
Liabilities - Accounts payable and other liabilities		<hr/>
		14,962
Net Position Held In Trust for Pension Benefits (a schedule of funding progress is presented in the required supplemental information)		<hr/>
		\$ 226,938,511

City of Pontiac Police and Fire Retirement System

Statement of Changes in Plan Net Position Year Ended December 31, 2012

Additions

Investment income:	
Interest and dividends	\$ 3,687,538
Net increase in fair value of investments	23,078,332
Less investment-related expenses	<u>(687,212)</u>
Net investment income	26,078,658
Contributions:	
Employer	2,176,867
Employee	44,842
Total contributions	<u>2,221,709</u>
Miscellaneous and litigation revenue	<u>67,072</u>
Total additions	28,367,439

Deductions

Retirees' pension benefits and retirement incentives	19,187,531
Member refunds and withdrawals	430,850
Charges from the City - Administrative expenses	<u>263,771</u>
Total deductions	<u>19,882,152</u>

Net Increase in Net Position Held in Trust 8,485,287

Net Position Held in Trust - January 1, 2012 218,453,224

Net Position Held in Trust - December 31, 2012 \$ 226,938,511

City of Pontiac Police and Fire Retirement System

Notes to Financial Statements December 31, 2012

Note I - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors 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 436 of 2012. 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.

In 2011 and 2012, the Retirement System filed a lawsuit against the plan sponsor to compel payment on past due contributions for the years ended 2010 and 2011, respectively. In 2013, a settlement agreement was reached between the Retirement System and City that resulted in payment for past due contributions in the amounts of \$448,541 and \$826,524 for plan years 2010 and 2011, respectively. These amounts, which had previously been omitted from the financial statements, have been recognized in both revenue and receivables as of December 31, 2012. Contributions for 2012 in the amount of \$901,797 were also remitted in accordance with the actuarial valuation and have also been included in revenue and receivables at year end.

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.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

City of Pontiac Police and Fire Retirement System

Notes to Financial Statements December 31, 2012

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 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

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.

Partial Termination and Plan Closure - 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.

As of March 1, 2012, plan membership has decreased to zero and 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 - In accordance with the State Constitution, the City is required to contribute at an actuarially determined rate. Administrative costs are financed through investment earnings.

City of Pontiac Police and Fire Retirement System

Notes to Financial Statements December 31, 2012

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 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		
	2012	2011	2010
Annual pension cost (APC)	\$ 901,797	\$ 931,311	\$ 887,134
Percentage of APC contributed	100.0 %	89.0 %	100.0 %
Net pension obligation	\$ -	\$ -	\$ -

Reserves - As of December 31, 2012, the plan's legally required reserves have been fully funded as follows:

Reserve for employees' contributions	\$ 1,795,844
Reserve for retired benefit payments	215,754,908

Note 3 - Membership Information

Membership consisted of the following:

	December 31, 2012	March 1, 2012
Retirees and beneficiaries currently receiving benefits	450	455
Terminated employees entitled to benefits but not currently receiving benefits	158	161

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

City of Pontiac Police and Fire Retirement System

Notes to Financial Statements December 31, 2012

Note 4 - 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, 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 three types of risk, which are examined in more detail below:

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. At December 31, 2012, the Retirement System had bank deposits totaling \$390 per the Retirement Systems accounting records. 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.

City of Pontiac Police and Fire Retirement System

Notes to Financial Statements December 31, 2012

Note 4 - Deposits and Investments (Continued)

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 Value	Weighted Average Maturity (in Years)
U.S. governmental investments:		
Government agencies	\$ 3,870,214	2.64 years
Government mortgage-backed securities	17,909,534	1.07 years
Bond index fund	17,695,993	4.67 years
Corporate and other bonds	20,093,458	4.04 years

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Retirement System's investment policy limits investments in domestic fixed-income securities to not less than a B rating for an overall average quality of each high-yield portfolio; the overall quality rating of each high-grade portfolio must be AA or an equivalent rating; for domestic equity investments, the securities must be the equivalent of Standard & Poor's A1 or Moody's P-1; for global bonds, the overall average quality must be AA or higher. As of year end, the credit quality ratings of debt securities are as follows:

Investment	Fair Value	S&P 500 Rating
Bond index fund	\$ 17,695,993	Unrated
Corporate bonds	2,055,991	AA
Corporate bonds	14,727,230	A
Corporate bonds	3,310,236	Bbb
Short-term investment funds	8,293,941	Unrated
Government agencies	3,870,214	AA

Required Supplemental Information

City of Pontiac Police and Fire Retirement System

Required Supplemental Information Schedule 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	\$ 253,702,503	\$ 229,779,819	\$(23,922,684)	110.4	\$ 13,758,914	-
12/31/06	258,738,855	231,715,863	(27,022,992)	111.7	12,831,719	-
12/31/07	271,992,032	235,981,324	(36,010,708)	115.3	11,066,828	-
12/31/08	265,251,339	238,217,676	(27,033,663)	111.3	9,749,807	-
12/31/09	259,240,616	243,283,874	(15,956,742)	106.6	7,405,796	-
12/31/10	253,878,331	244,915,039	(8,963,292)	103.7	6,667,866	-
12/31/11	239,781,316	245,699,778	5,918,462	97.6	3,141,128	188.4
3/1/12	239,781,216	248,335,145	8,553,929	96.6	-	N/A
12/31/12	221,258,667	251,758,049	30,499,382	87.9	-	N/A

* The March 1, 2012 valuation uses the funding value of assets as of December 31, 2011. The December 31, 2012 valuation excludes contributions receivable of \$1,467,987.

Required Supplemental Information Schedule of Employer Contributions Year Ended December 31, 2012

Years Ended	Annual Required Contribution	Percentage Contributed
12/31/07	\$ 2,344,231	100.0
12/31/08	1,829,115	100.0
12/31/09	1,230,190	100.0
12/31/10	887,134	100.0
12/31/11	931,311	89.0
12/31/12	901,797	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2012, the latest actuarial valuation, 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%
Cost of living adjustments	2%
*Includes inflation at	4.0%