

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

---

**Financial Report**  
**with Required Supplemental Information**  
**December 31, 2006**

plante  
*m*  
moran

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

---

## **Contents**

<b>Report Letter</b>	<b>1</b>
<b>Management's Discussion and Analysis</b>	<b>2-3</b>
<b>Basic Financial Statements</b>	
Statement of Plan Net Assets	4
Statement of Changes in Plan Net Assets	5
Notes to Financial Statements	6-11
<b>Required Supplemental Information</b>	<b>12</b>
Schedule of Analysis of Funding Progress	13
Schedule of Employer Contributions	14



Plante & Moran, PLLC  
27400 Northwestern Highway  
P.O. Box 307  
Southfield MI 48037-0307  
Tel: 248 352 2500  
Fax: 248 352 0018  
plantemoran.com

## 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, 2006 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, 2006 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 12, 2007

# 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:

	2006	2005
Total assets	\$ 268,748,496	\$ 269,657,894
Total liabilities:		
Amounts due broker under securities lending agreement	-	19,209,862
Other liabilities	683,305	335,558
Total liabilities	683,305	19,545,420
Assets held in trust for pension benefits	<u>\$ 268,065,191</u>	<u>\$ 250,112,474</u>
Net investment income	\$ 28,773,344	\$ 14,183,335
Net securities lending income	22,776	18,047
Contributions:		
Employee	340,825	384,353
Employer	2,324,011	2,246,000
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	13,054,385	12,528,135
Member refunds and withdrawals	159,866	355,021
Total benefits paid	13,214,251	12,883,156
Benefits paid in excess of contributions	10,549,415	10,252,803
Ratio of benefits paid to contributions	495.9%	489.8%
General and administrative expenses	293,988	428,192
Net increase in net assets held in trust	<u>\$ 17,952,717</u>	<u>\$ 3,520,387</u>

# 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, 2006:

Domestic equities	41%
International equities	14%
Domestic fixed income	37%
Real estate	8%

### Investment Results

In 2006, the stock market remained attractive relative to the bond market as the S&P 500 earnings yield outpaced the 30-year Treasury yield. The bond market was up modestly as the Fed kept interest rates steady toward the end of the year. The domestic equity market grew from last year. The S&P 500 ended the year up 15.8 percent. The fixed income market, measured by the Lehman Aggregate Index, returned 4.6 percent for the year. The international index, MSCI EAFE, was up 10.4 percent for the quarter and 26.3 percent for the year. The total fund returned 10.8 percent for the year.

The Retirement System's total fund return must always be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the Retirement System to pay the benefits promised to members and retirees are very long-term obligations. 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 Assets December 31, 2006

### Assets

Cash (Note 3)	\$ 100,735
Accounts receivable:	
Due to City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust	50,362
Due from City of Pontiac	211,180
Other	416
	<hr/>
Total accounts receivable	261,958
Accrued interest and dividends receivable	499,368
Investments at fair value (Note 3):	
Money market and mutual funds	4,913,243
U.S. government obligations	5,709,584
Corporate and other bonds	56,412,806
Equities	169,562,868
U.S. government agency mortgage pools	13,046,659
Interest in CAP Commercial Mortgage, LLC	1,891,855
Real estate	16,349,420
	<hr/>
Total investments	267,886,435
	<hr/>
Total assets	268,748,496

### Liabilities

Accounts payable	265,886
Due to City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust	891
Due to City of Pontiac General Employees' Retirement System	8,945
Amounts due to broker for pending transactions	407,583
	<hr/>
Total liabilities	683,305

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

**\$ 268,065,191**

# City of Pontiac Police and Fire Retirement System

## Statement of Changes in Plan Net Assets Year Ended December 31, 2006

### Additions

Investment income (loss):	
Interest and dividend income	\$ 3,358,080
Net appreciation in fair value	26,545,069
Investment advisor fees	<u>(1,129,805)</u>
Net investment income	28,773,344
Securities lending income (loss):	
Interest and fees	716,850
Less borrower rebates	<u>(694,074)</u>
Net securities lending income	22,776
Contributions:	
Employee	340,825
Employer	<u>2,324,011</u>
Total additions	31,460,956

### Deductions

Retirees' pension benefits and retirement incentives	13,054,385
Member refunds and withdrawals	159,866
Other expenses	177,169
Charges from City - Administrative expenses	<u>116,819</u>
Total deductions	<u>13,508,239</u>

<b>Net Increase in Net Assets Held in Trust for Pension Benefits</b>	<b>17,952,717</b>
<b>Net Assets Held in Trust for Pension Benefits - January 1, 2006</b>	<b><u>250,112,474</u></b>
<b>Net Assets Held in Trust for Pension Benefits - December 31, 2006</b>	<b><u>\$ 268,065,191</u></b>

# City of Pontiac Police and Fire Retirement System

Notes to Financial Statements  
December 31, 2006

## Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") sponsors and administers the City of Pontiac Police and Fire Retirement System (the "Retirement System") (a contributory single-employer retirement plan) that covers all police and fire employees of the City.

**Reporting Entity** - The financial statements of the Retirement System are also included in the combined financial statements of the City of Pontiac as a pension trust fund. The assets of the pension trust fund include no securities of or loans to the City or any other related party.

**Basis of Accounting** - The Retirement System's financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

**Methods Used to Value Investments** - Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments and are discounted at prevailing interest rates for similar instruments. The fair value of real estate investments is based on independent appraisals or audited financial statements.

## Note 2 - Plan Description and Contribution Information

At December 31, 2005, the date of the most recent actuarial valuation, membership consisted of the following:

Retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits, but not yet receiving them	367
Current employees:	
Fully vested	136
Nonvested	113
Total	249



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

---

**Notes to Financial Statements  
December 31, 2006**

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

**Plan Description** - The Retirement System provides retirement benefits, as well as death and disability benefits. Employees may receive cost of living adjustments as a percentage of their base amounts, pursuant to the collective bargaining agreement in effect at their date of retirement. The obligation to contribute to and maintain the Retirement System was established by City ordinance and negotiation with the employees' collective bargaining units.

**Contributions** - Plan members are required to contribute 2.5 percent of their annual salaries. The Retirement System is required to contribute at an actuarially determined rate. Administrative costs are financed through investment earnings.

## **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.

# City of Pontiac Police and Fire Retirement System

**Notes to Financial Statements  
December 31, 2006**

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

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:

### **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 approximately \$1,000 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Retirement System believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, 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	Weighted Average Maturity
U.S. government obligations	\$ 5,809,396	14.7 years
Corporate and other bonds	56,643,658	4.74 years
U.S. government agency mortgage pools	13,122,995	24.97 years
Money market and mutual funds	4,509,575	0.09 years

# City of Pontiac Police and Fire Retirement System

Notes to Financial Statements  
December 31, 2006

## 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 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 Type	Fair Market Value	Moody's Rating
Corporate and other bonds	\$ 40,506,216	Unrated
Corporate and other bonds	4,236,388	A1
Corporate and other bonds	439,785	A2
Corporate and other bonds	1,061,477	A3
Corporate and other bonds	2,614,864	AA1
Corporate and other bonds	1,068,796	AA2
Corporate and other bonds	4,348,767	AA3
Corporate and other bonds	1,661,150	AAA
Corporate and other bonds	706,213	BAA2
U.S. government agency mortgage pools	5,511,554	U.S. Agency
U.S. government agency mortgage pools	1,042,309	AA2
Money market and mutual funds	4,509,575	Unrated

### Concentration of Credit Risk

The Retirement System's investment policy states that an investment manager may not have an investment in one single issuer in excess of 5 percent of that manager's total assets without written consent of the board. The investment in CAPROC, totaling approximately \$14,321,000, represents more than 5 percent of the Retirement System's net assets. Two of the 12 members on the CAPROC board are police and fire trustees.

# City of Pontiac Police and Fire Retirement System

Notes to Financial Statements  
December 31, 2006

## Note 3 - Deposits and 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 Retirement System limits total assets in international equities and mutual funds to 14 percent of the total pension system's market value. The internal equities and mutual funds of the police and fire pension plan were denominated in U.S. currency. Accordingly, there were no securities subject to foreign currency risk.

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, 2006, only United States currency was received as collateral.

The Retirement System did not impose any restrictions during the fiscal year on the amount of loans made on its behalf by the custodial bank. There were no failures by any borrowers to return loaned securities or pay distributions thereon during the fiscal year. Moreover, there were no losses during the fiscal year resulting from a default of the borrowers or custodial bank.

The Retirement System and the borrower maintain the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other lenders, in an investment pool. Because the loans are terminable on demand, their duration did not generally match the duration of the investments made with cash collateral. On December 31, 2006, the Retirement System had no securities on loan due to the fact that they changed custodians at year end.

## Note 4 - Reserves

State law requires employee contributions to be segregated. In addition, amounts must be set aside as determined by the actuary to fund benefits to retirees currently approved to receive benefits. As of December 31, 2006, the Retirement System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 3,478,134
Reserved for retired employees	148,226,621

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

---

**Notes to Financial Statements  
December 31, 2006**

## **Note 5 - Subsequent Event**

During April 2007, the System entered into a buy-out agreement related to certain investments in real estate. In exchange for the System's interest in the investment, the System received \$4,695,000 of cash at closing, as well as an assignment of an interest in a related mortgage company valued at \$1,739,000. The System entered into a note for the remaining balance of approximately \$9,470,000, including accrued interest of \$280,000. The investment was valued at \$15,589,000 as of December 31, 2006.

## **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
12/31/2000	\$ 239,667,248	\$ 191,594,863	\$ (48,072,385)	125.1	\$ 13,462,955	-
12/31/2001	245,966,812	203,166,600	(42,800,212)	121.1	13,710,467	-
12/31/2002	239,657,864	204,588,488	(35,069,376)	117.1	13,528,501	-
12/31/2003* #	244,770,438	216,553,276	(28,217,162)	113.0	15,308,134	-
12/31/2004 #	249,927,425	225,466,883	(24,460,542)	110.8	15,830,247	-
12/31/2005	253,702,503	229,779,819	(23,922,684)	110.4	13,758,914	-

\* Plan amended

# Certain assumptions revised

# City of Pontiac Police and Fire Retirement System

## Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2001	\$ 2,168,043	100.0
2002	1,809,736	100.0
2003	2,008,947	100.0
2004	2,141,247	100.0
2005	2,242,320	100.0
2006	2,324,011	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2005, the latest actuarial valuation, follows:

Actuarial cost method	Individual entry age normal cost
Amortization method	Level percent of payroll
Remaining amortization period	20 years, open
Asset valuation method	Market value with five-year smoothing of changes in security prices
Actuarial assumptions:	
Investment rate of return*	7.5%
Projected salary increases*	4.5% to 13.6%
*Includes inflation at	4.0%
Cost of living adjustments	2%