

City of Pontiac
Police and Fire Retirement System

Financial Report
with Required Supplemental Information
December 31, 2010

City of Pontiac Police and Fire Retirement System

Contents

Report Letter	1
Management's Discussion and Analysis	2-3
Basic Financial Statements	
Statement of Plan Net Assets	4-5
Statement of Changes in Plan Net Assets	6
Notes to Financial Statements	7-13
Required Supplemental Information	14
Schedule of Analysis of Funding Progress	15
Schedule of Employer Contributions	16

Independent Auditor's Report

To the 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, 2010 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, 2010 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and required supplemental information (identified in the table of contents) are not required parts of the basic financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

June 20, 2011

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:

	2010	2009
Total assets	\$ 272,517,587	\$ 258,820,688
Total liabilities:		
Amounts due broker under securities lending agreement	33,289,538	31,319,605
Other liabilities	<u>220,480</u>	<u>278,510</u>
Total liabilities	<u>33,510,018</u>	<u>31,598,115</u>
Assets held in trust for pension benefits	<u>\$ 239,007,569</u>	<u>\$ 227,222,573</u>
Net investment gain	\$ 27,633,257	\$ 33,977,599
Net securities lending income (loss)	50,851	(5,317)
Contributions:		
Employee	352,233	264,814
Employer	887,134	1,230,190
Other - Miscellaneous and litigation revenue	398,431	135,732
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	\$ (16,885,689)	\$ (14,975,806)
Member refunds and withdrawals	<u>(280,755)</u>	<u>(929,771)</u>
Total benefits paid	<u>\$ (17,166,444)</u>	<u>\$ (15,905,577)</u>
Benefits paid in excess of contributions	<u>\$ 15,927,077</u>	<u>\$ 14,410,573</u>
General and administrative expenses	\$ (370,466)	\$ (281,509)
Net increase in net assets held in trust	11,784,996	19,415,932

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 (excluding the collateral pool) as of December 31, 2010:

Domestic equities	43%
Domestic fixed income	33%
International equities and fixed income	14%
Real estate	4%
Basket Clause Category Securities	3%
Cash	3%

Investment Results

2010 marked the second year of economic recovery from the great recession. Inflation was under control; however, commodity prices rose sharply during the second half of the year. Central banks maintained accommodative policies, holding interest rates down (at near historic low levels). The fixed-income market as measured by the Barclays Aggregate Index returned 6.5 percent for the year. The equity markets posted solid returns for the second consecutive year (albeit lower than 2009); the S&P 500 rose 15.1 percent, the Russell 2000 Index (a proxy for U.S. small-cap stocks) jumped 26.9 percent, and the MSCI EAFE Index (a proxy for international stocks) gained 7.8 percent. The total Retirement System gained 12.94 percent, net of related fees for the year ended December 31, 2010.

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 Assets December 31, 2010

Assets	
Cash (Note 3)	\$ 100,586
Accrued interest and dividends receivable	240,579
Accounts receivable:	
Due from City of Pontiac Police and Fire Retiree Prefunded	
Group Health and Insurance Trust	187,162
Due from City of Pontiac	721,070
Due from City of Pontiac General Employees' Retirement System	<u>4,589</u>
Total accounts receivable	912,821
Cash and investments held as collateral for securities lending (Note 3):	
Repurchase agreements	8,998,162
Agency bonds and notes	6,551,381
Certificates of deposit	5,862,288
Time deposits	3,259,046
Asset-backed floating rate notes	2,932,808
Commercial paper	2,240,386
Variable rate certificates of deposit	1,468,069
Variable rate notes and bonds	1,238,371
Sovereign guaranteed commercial paper	479,369
Sweep vehicles	183,092
Corporate bonds	<u>76,566</u>
Total cash and investments held as collateral for securities lending	33,289,538
Investments at fair value (Note 3):	
Money market and mutual funds	7,953,364
U.S. government agency notes and debentures	10,007,616
High-yield bonds	4,682,073
Corporate and other bonds	17,616,363
Equities	134,483,277
Private equities	9,304,792
Real estate	7,334,285
U.S. government mortgage-backed securities	14,324,800
Commercial mortgage pools	2,695,107
Asset-backed securities	1,169,183
Other fixed income	<u>28,403,203</u>
Total investments at fair value	<u>237,974,063</u>
Total assets	272,517,587

City of Pontiac Police and Fire Retirement System

Statement of Plan Net Assets (Continued) December 31, 2010

Liabilities	
Accounts payable and other liabilities	\$ 220,480
Amounts due to broker under securities lending agreement (Note 3)	<u>33,289,538</u>
Total liabilities	<u>33,510,018</u>
Net Assets Held in Trust for Pension Benefits (a schedule of funding progress is presented in the additional information)	<u>\$ 239,007,569</u>

City of Pontiac

Police and Fire Retirement System

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

Additions

Miscellaneous and litigation revenue	\$ 398,431
Securities lending income:	
Interest and fees	95,505
Less borrower rebates	<u>(44,654)</u>
Net securities lending income	50,851
Contributions:	
Employee	352,233
Employer	<u>887,134</u>
Total contributions	1,239,367
Investment income:	
Interest and dividend income	3,223,736
Net appreciation in fair value	25,273,088
Investment advisor fees	<u>(863,567)</u>
Net investment income	<u>27,633,257</u>
Total additions	29,321,906

Deductions

Retirees' pension benefits and retirement incentives	(16,885,689)
Member refunds and withdrawals	(280,755)
Other expenses	(265,149)
Charges from the City - Administrative expenses	<u>(105,317)</u>
Total deductions	<u>(17,536,910)</u>
Net Increase in Net Assets Held in Trust for Pension Benefits	11,784,996
Net Assets Held in Trust for Pension Benefits - Beginning of year	<u>227,222,573</u>
Net Assets Held in Trust for Pension Benefits - End of year	<u><u>\$ 239,007,569</u></u>

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2010

Note I - 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 plan.

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. 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

Police and Fire Retirement System

Notes to Financial Statements December 31, 2010

Note 2 - Plan Description and Contribution Information

At December 31, 2009, 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	430
Current employees:	
Fully vested	99
Nonvested	39
Total	138

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.

Potential Partial Termination - The City's Emergency Manager has been in discussions with Oakland County related to transferring policing duties to the County. Depending on the circumstances surrounding the transfer, it is possible that a partial termination of the plan may occur. The effect of a partial termination on the funded status of the plan is not currently known.

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.

Annual Pension Costs - The annual contribution for the year ended December 31, 2010 was \$0. The annual contribution for the plan year was determined as part of actuarial valuations at December 31, 2007 and 2008, 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. 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, 2010

Note 2 - Plan Description and Contribution Information (Continued)

Funded Status and Funding Progress - Per the actuarial report dated December 31, 2009, all assumptions have remained consistent. As of December 31, 2009, the most recent actuarial valuation date, the plan was 106.5 percent funded. The actuarial accrued liability for benefits was \$243,283,874 and the actuarial value of assets was \$259,240,616, resulting in actuarial accrued assets of \$15,956,742. The covered payroll (annual payroll for active employees covered by the plan) was \$7,405,796 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		
	2008	2009	2010
Annual pension costs (APC)	\$ 1,829,115	\$ 1,230,190	\$ 887,134
Percentage of APC contributed	100%	100%	100%
Net pension obligation	\$ -	\$ -	\$ -

See Note 4 for disclosures of required reserves.

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.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements

December 31, 2010

Note 3 - Deposits and Investments (Continued)

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:

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.

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2010

Note 3 - 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 Market Value	Effective Duration/Specific Maturity Identification
Asset-backed securities	\$ 839,246	.145 years
Asset-backed securities	329,937	Unavailable
Commercial mortgage-backed securities	330,002	1.17 years
Corporate and other bonds	5,970,473	5.28 years
Corporate and other bonds	16,327,963	Unavailable
U.S. governmental investments:		
Government bonds	9,155,058	6.99 years
Government bonds	852,558	5.75 years
Government mortgage-backed securities	9,044,723	3.76 years
Government mortgage-backed securities	1,924,272	Unavailable
Government mortgage-backed securities	1,863,196	11/1/2038
Government mortgage-backed securities	716,291	5/25/2040
Government mortgage-backed securities	435,837	4/20/2037
Government mortgage-backed securities	340,482	7/25/2040
Nongovernment-backed CMOs	121,108	.01 years
Nongovernment-backed CMOs	35,177	Unavailable
Collateral pool	33,289,538	.07 years

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements December 31, 2010

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	Moody's/S&P 500 Rating
Asset-backed securities	\$ 372,778	Aaa
Asset-backed securities	516,410	Aa
Asset-backed securities	156,061	A
Asset-backed securities	123,935	Bbb
Corporate bonds	1,557,895	A
Corporate bonds	4,412,577	Bbb
U.S. government bonds	5,713,239	Aaa
Nongovernment-backed securities	121,108	Aaa
Nongovernment-backed securities	35,177	Unrated
Commercial mortgage-backed securities	330,002	Aaa
Comingled funds	6,857,744	AAA
Comingled funds	1,959,356	AA
Comingled funds	1,632,796	A
Comingled funds	816,398	BBB
Comingled funds	5,061,669	Unrated
Other fixed-income pool	20,232,055	AAA
Other fixed-income pool	1,698,831	AA
Other fixed-income pool	3,688,402	A
Other fixed-income pool	2,870,341	BAA
Other fixed-income pool	14,252	BAI
Short-term investment funds	10,382,034	AI +
Collateral pool	33,289,538	A+

City of Pontiac

Police and Fire Retirement System

Notes to Financial Statements
December 31, 2010

Note 3 - Deposits and Investments (Continued)

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, 2010, 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. The average duration of such investment pool as of December 31, 2010 was 25 days. 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, 2010, the Retirement System had no credit risk exposure to borrowers. The collateral held and the fair market value of underlying securities on loan for the Retirement System as of December 31, 2010 were \$33,289,538 and \$32,517,548, respectively.

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, 2010, the Retirement System's reserves have been fully funded as follows:

Reserved for employee contributions	\$ 2,599,892
Reserved for retired employees	194,418,962

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
12/31/2004 #	\$ 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	-
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	-

Certain assumptions revised

City of Pontiac Police and Fire Retirement System

Schedule of Employer Contributions

Year Ended December 31	Annual Required Contribution	Percentage Contributed
2005	\$ 2,242,320	100.0
2006	2,324,011	100.0
2007	2,344,231	100.0
2008	1,829,115	100.0
2009	1,230,190	100.0
2010	887,134	100.0

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2009, the latest actuarial valuation, is as follows:

Actuarial cost method	- Individual entry age normal cost
Amortization method	- Level percent of payroll, open
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%-13.6%
Cost of living adjustments	- 2%
*Includes inflation at	- 4.0%