

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

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**Financial Report  
with Supplemental Information  
December 31, 2016**

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

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## Independent Auditor's Report

To the Board of Trustees  
City of Pontiac General Employees'  
Retirement System

### **Report on the Financial Statements**

We have audited the accompanying statement of fiduciary net position and the related statement of changes in fiduciary net position of the City of Pontiac General Employees' Retirement System (the "System") as of and for the year ended December 31, 2016 and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

#### ***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 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 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.

To the Board of Trustees  
City of Pontiac General Employees'  
Retirement System

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the City of Pontiac General Employees' Retirement System as of December 31, 2016 and the changes in fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

As discussed in Note 1 to the basic financial statements, effective as for the year ended December 31, 2016, the System adopted the provisions of GASB Statement No. 72, *Fair Value Measurement and Application*. As a result of adopting this new accounting standard, the notes to the financial statements now include enhanced disclosures about fair value measurement, the level of fair value hierarchy, and valuation techniques. Our opinion is not modified with respect to this matter.

***Other Matters***

*Required Supplemental Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplemental information, 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 21, 2017

# City of Pontiac General Employees' Retirement System

## Management's Discussion and Analysis

### Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the basic financial statements, and (3) required supplemental information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The financial statements are followed by a section of required supplemental information that further explains and supports the information in the financial statements.

### Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	2016	2015
Total assets	\$ 466,955,940	\$ 460,056,776
Total liabilities	<u>803,908</u>	<u>714,422</u>
Net position restricted for pensions	<u><b>\$ 466,152,032</b></u>	<u><b>\$ 459,342,354</b></u>
Net investment income (loss)	\$ 34,606,547	\$ (3,414,613)
Other - Miscellaneous and litigation revenue	5,748	37,358
Retiree pension and annuity benefits	(27,119,534)	(28,052,593)
General and administrative expenses	<u>(683,083)</u>	<u>(813,057)</u>
Net increase (decrease) in net position restricted for pensions	<u><b>\$ 6,809,678</b></u>	<u><b>\$ (32,242,905)</b></u>

### Overall Fund Structure and Objectives

The City of Pontiac General Employees' Retirement System (the "System") exists to pay benefits to its members and retirees. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

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

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

### **Asset Allocation**

The System has established asset allocation policies that are expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the System. The following is a summary of the adopted asset allocation (excluding the collateral pool) as of December 31, 2016:

Domestic equities	45%
Domestic fixed income	25
International equities	5
Emerging markets	5
Real estate	10
Private equities	10
Cash	0

### **Investment Results**

After a rather inauspicious beginning, U.S. equity markets came roaring back in the fourth quarter and ended the year in positive territory. Fears of a slowdown in economic growth in China and uncertainty over the Brexit vote in the United Kingdom, which had tempered investor enthusiasm, seemingly disappeared after Election Day in the United States. The S&P 500 soared by 5 percent from November 9, 2016 through the end of the fourth quarter ending the year up 12 percent. U.S. equity markets were up double-digits in most cases and crude oil prices almost doubled from their February 2016 low of \$26/bbl.

Rising prices for oil and other commodities, accommodative monetary policies, and efforts at economic reform helped emerging markets to notch their strongest performance since 2012 and to significantly outperform their developed markets peers with Brazilian and Russian equities registering the largest gains. With the exception of China, most Asian markets were up for the year. The MSCI-Emerging Markets index rose 11.6 percent. Continued quantitative easing by the European Central Bank and political uncertainty will remain factors for the European markets in 2017 and Japan's inflation and economic growth remains low despite aggressive monetary and fiscal stimulus.

After a year-long pause, the Federal Reserve raised interest rates by 25 bps in December 2016. However, this move was widely anticipated and largely overlooked as investors focused on the potential impact the new administration's policies on infrastructure spending, business regulation, and taxes will have on economic growth in the coming year. GDP growth in 2016 was revised up to 2.1 percent as of April 28, 2017.

The dollar continued to strengthen (3.6 percent) and inflation was 2.1 percent up from .7 percent in 2015 and in line with the Federal Reserve's target of 2 percent.

The Barclay's U.S. Aggregate Index returned 2.7 percent for the year. The Standard & Poor's 500 returned 12 percent and the MSCI EAFE Index (a proxy for developed markets international stocks) returned 1.0 percent. The total plan returned 8.4 percent for the year.

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

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

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

The City of Pontiac, Michigan (the plan sponsor) (the "City") had experienced significant financial difficulty and in 2009 was placed in receivership under Michigan Public Act 436 of 2012. On March 31, 2016 the State returned local control of the City's operations to Mayor Deirdre Waterman and the Pontiac City Council. In February 2016, the City Council proposed a resolution which - if adopted - would provide an early retirement benefit to certain former employees. On April 4, 2017, the City announced that a tentative settlement had been reached in the retiree healthcare litigation matter. The settlement agreement must be approved by various parties, including the City Council, Federal District Court, and IRS, among others, and would impact the funded status of the System. The System is currently overfunded and no employer contributions are required at this time. Should a contribution to the System be required in the future, there is uncertainty regarding the City's ability and intent to make contributions to the System.

### **Contacting the System's Management**

This financial report is intended to provide a general overview of the System's finances and investment results in relation to actuarial projections. It shows the System's accountability for the money it receives from employer and employee contributions. If you have questions about this report or need additional information, we welcome you to contact the System's office at 2201 Auburn Road, Suite B, Auburn Hills, MI 48326.

# City of Pontiac General Employees' Retirement System

## Statement of Fiduciary Net Position December 31, 2016

### Assets

Cash and cash equivalents (Note 3)	\$	179
Investments at fair value (Note 3):		
Short-term investments		16,118,772
Government agency notes and debentures		38,640,291
Corporate and other bonds		25,436,065
Domestic equities		282,318,729
Private equity		13,503,583
U.S. government mortgage-backed securities		14,427,481
State and local bonds		10,730,447
Commercial mortgage pools		5,260,245
Asset-backed securities		4,996,713
Limited partnerships		54,380,569
Receivables:		
Accrued interest receivable		1,133,243
Other receivables		9,623
		<hr/>
Total assets		466,955,940

**Liabilities** - Accounts payable and other 

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 803,908

**Fiduciary Net Position** - Restricted for pensions 

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 **\$ 466,152,032**



# City of Pontiac General Employees' Retirement System

## Statement of Changes in Fiduciary Net Position Year Ended December 31, 2016

### Additions

Investment income:	
Interest and dividends	\$ 7,886,702
Net increase in fair value of investments	29,311,087
Less investment advisor fees	<u>(2,591,242)</u>
Net investment income	34,606,547
Miscellaneous income	<u>5,748</u>
Total additions	34,612,295

### Deductions

Retirees' pension benefits	27,119,534
Administrative expenses	<u>683,083</u>
Total deductions	<u>27,802,617</u>

**Net Change in Fiduciary Net Position Restricted for Pensions** 6,809,678

**Fiduciary Net Position Restricted for Pensions - Beginning of year** 459,342,354

**Fiduciary Net Position Restricted for Pensions - End of year** \$ 466,152,032

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 1 - Summary of Significant Accounting Policies

The City of Pontiac, Michigan (the "City") sponsors and administers the City of Pontiac General Employees' Retirement System (the "System") (a contributory single-employer retirement plan) that covers substantially all employees and retirees of the City, except police and fire employees and retirees.

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

**Plan Sponsor Financial Condition** - The City of Pontiac, Michigan (the plan sponsor) was experiencing significant financial difficulty. In early 2013, the City was in receivership under Michigan Public Act 436 of 2012. The result was that the State had appointed an emergency manager to control the finances of the City. As of the end of fiscal year 2013, the City was no longer under receivership, but was governed by a transitional advisory board. On March 31, 2016, the State amended Executive Order S-334 and rescinded Executive Order S-332. These changes effectively restored much of the city charter powers to the mayor and City Council. The System is currently overfunded and no employer contributions are required at this time.

**Basis of Accounting** - The System follows accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. Accounting and financial reporting pronouncements are promulgated by the Governmental Accounting Standards Board (GASB).

The 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 pursuant to legal requirements. 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 estimated 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. Investments that do not have an established market value are reported at estimated fair value as determined by the System's management. These estimates are determined using audited financial statements issued by the private equity companies or limited partnerships in which such investments are held, adjusted by management as deemed appropriate based on known circumstances.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 1 - Summary of Significant Accounting Policies (Continued)

Approximately 15 percent of the System's assets are not publicly traded and therefore do not have a readily determinable market value. Because these investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ significantly from the values that would have been used had a ready market for these securities existed. The difference could be material.

**New Accounting Pronouncements Adopted** - During fiscal year 2016, the System adopted GASB Statement No. 72, *Fair Value Measurement and Application*, which increased the disclosure requirements for the System related to its investments. GASB 72 establishes a hierarchy of inputs used to measure fair value consisting of three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. Investments that are measured at net asset per share (or its equivalent) are disclosed separately. GASB 72 also contains note disclosure requirements regarding the hierarchy of valuation inputs and valuations techniques that were used for the fair value measurements. There was no material impact to the System's financial statements as a result of the implementation of GASB 72.

### Note 2 - Pension Plan

**Plan Administration** - The System's board administers the City of Pontiac General Employees' Retirement System Pension Plan - a single-employer defined benefit pension plan that provides pensions for substantially all permanent full-time general employees of the City of Pontiac, Michigan, except police and fire employees. Benefit terms have been established by contractual agreements between the City of Pontiac, Michigan and the various employee union representation; amendments are subject to the same process.

The board of trustees consists of 11 members - a member of the City Council to be selected by the city council, the mayor of the City of Pontiac, Michigan, the finance director of the City of Pontiac, Michigan, three citizen appointees, three member trustees - one elected by active employees and two elected by active, deferred, and retired members - one retiree trustee elected by retirees, and one hospital member (could be deferred vested member or retired member) of the System who was formally employed by Pontiac General Hospital, elected via an election conducted by the hospital with the assistance of the Retirement Office.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 2 - Pension Plan (Continued)

**Plan Membership** - At December 31, 2016, pension plan membership consisted of the following:

Retirees and beneficiaries	1,089
Inactive plan members entitled to but not yet receiving benefits	201
Active plan members	31

The plan is closed to all new hires after April 1, 2013, except for those new hires that are hired under the Michigan Association of Public Employees (representing the 50th District Court employees) collective bargaining agreement.

**Benefits Provided** - The System provides retirement benefits as well as death and disability benefits. Employees may receive cost-of-living adjustments as a percentage of their retirement allowance, pursuant to the collective bargaining agreement or employment agreement in effect at their date of retirement. The obligation to contribute to and maintain the System was established by city ordinance and negotiation with the employees' collective bargaining units.

**Contributions** - Article 9, Section 24 of the State of Michigan Constitution requires that financial benefits arising on account of employee service rendered in each year be funded during that year. Accordingly, the board of trustees retains an independent actuary to determine the annual contribution. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by plan members during the year, with an additional amount to finance any unfunded accrued liability. Contribution requirements of plan members are established in accordance with city ordinance, union contracts, and plan provisions. For the year ended December 31, 2016, the active members were not required to contribute to the System. The City is required to contribute at an actuarially determined rate. In accordance with the actuary recommendation, the City did not have to make a contribution to the System in the current year. Administrative costs are financed through investment earnings.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 2 - Pension Plan (Continued)

#### Pension Plan Investments - Policy and Rate of Return

**Investment Policy** - The System's policy in regard to the allocation of invested assets is established and may be amended by the board of trustees by a majority vote of its members. It is the policy of the board of trustees to pursue an investment strategy that manages risk through the prudent diversification of the portfolio across a broad selection of distinct asset classes. The System's investment policy discourages the use of cash equivalents, except for liquidity purposes, and aims to refrain from dramatically shifting asset class allocations over short time spans. The following was the board's adopted asset allocation policy as of December 31, 2016:

<u>Asset Class</u>	<u>Target Allocation</u>
Domestic equity - Large cap	20.00%
Domestic equity - Mid cap	15.00
Domestic equity - Small cap	10.00
International equity	5.00
Emerging markets equity	5.00
Fixed income - Core	25.00
Real estate	10.00
Private equity	10.00

**Rate of Return** - For the year ended December 31, 2016, the annual money-weighted rate of return, net of expenses on system investments, was 7.79 percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

#### Pension Plan Reserves

In accordance with state law, the following reserves are required to be set aside within the pension plan:

The retiree reserve is to be computed annually by the actuary as the present value of estimated benefit payments for all current retirees. The amounts reserved may be used solely to pay monthly retiree benefit payments. The reserve is funded by actuarially determined transfers from the employer.

The employee reserve is credited as employee contributions are received throughout the year; the System maintains a record of the amount contributed by each employee, and credits interest annually at a rate of 4.0 percent. For any employee who terminates before vesting in the pension plan, his or her balance is returned to him or her; for those who stay until retirement, the balance is transferred into the retiree reserve.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 2 - Pension Plan (Continued)

The balances of the reserve accounts at December 31, 2016 are as follows:

	<u>Required Reserve Balance</u>
Retiree reserve	\$ 242,020,419
Employee reserve	553,879

#### Net Pension Asset of the City

The net pension asset of the City of Pontiac, Michigan has been measured as of December 31, 2016, based on benefits in force as of that date and is composed of the following:

Total pension liability	\$ 264,641,819
Plan fiduciary net position	<u>(466,152,032)</u>
City's net pension asset	<u>\$ (201,510,213)</u>

Plan fiduciary net position as a percentage of the total pension liability 176.14 %

**Actuarial Assumptions** - The total pension liability was determined by an actuarial valuation as of December 31, 2016. The valuation used the following actuarial assumptions applied to all periods included in the measurement:

Inflation	2.25 %
Salary increases	3.6-7.4 % Average, including inflation
Investment rate of return	7.0 % Net of pension plan investment expense, including inflation

Mortality rates were based on the RP-2014 Healthy Annuitant Mortality Table (unadjusted) projected to 2021 using a static projection based on the two-dimensional MP-2014 improvement scale.

**Discount Rate** - The discount rate used to measure the total pension liability was 7.00 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that City of Pontiac, Michigan's contributions will be made at rates equal to the difference between actuarially determined contribution rates and the employee rate. The discount rate changed from prior year by a 50 basis point reduction.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 2 - Pension Plan (Continued)

#### Projected Cash Flows

Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return as of December 31, 2016 for each major asset class included in the pension plan's target asset allocation, as disclosed in the investment note, are summarized in the following table:

<u>Asset Class</u>	<u>Long-term Expected Real Rate of Return</u>
Domestic equity - Large cap	5.58%
Domestic equity - Mid cap	5.92
Domestic equity - Small cap	5.92
International equity	5.71
Emerging markets equity	6.80
Fixed income - Core	2.27
Real estate	4.44
Private equity	8.02

**Sensitivity of the Net Pension Asset to Changes in the Discount Rate** - The following presents the net pension liability of the City of Pontiac, Michigan, calculated using the discount rate of 7.00 percent, as well as what the City of Pontiac, Michigan's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.00 percent) or 1 percentage point higher (8.00 percent) than the current rate:

	<u>1% Decrease (6.00%)</u>	<u>Current Discount Rate (7.00%)</u>	<u>1% Increase (8.00%)</u>
Net pension asset of the City	\$(175,740,476)	\$(201,510,213)	\$(223,369,575)

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 3 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The System is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The System is also authorized by Michigan Public Act 347 of 2012, 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 System's assets exceed \$250 million), debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The System has designated one bank for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all allowable investments under Michigan Public Act 347 of 2012, as amended. The System's deposits and investment policies are in accordance with statutory authority.

The System's cash and investments are subject to several types of risk, which are examined in more detail below:

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the System's deposits may not be returned to it. The System does not have a deposit policy for custodial credit risk. At year end, the System had no bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The System continues to evaluate each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

**Interest Rate Risk** - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System's investment policy does not restrict investment maturities.



# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

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

At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
Asset-backed securities	\$ 4,996,713	2.91 years
Commercial mortgage pools	5,186,771	28.58 years
Corporate bonds	25,436,065	7.96 years
Government agencies	2,496,613	10.98 years
Government bonds	31,208,891	6.99 years
Government mortgage-backed securities	14,427,481	24.91 years
Government issued commercial mortgage backed	1,422,032	1.57 years
Index linked government bonds	3,512,755	8.05 years
Municipal/provincial bonds	10,730,447	4.66 years
Nongovernment-backed commercial mortgage obligations	73,474	18.86 years
Short-term investment funds	16,118,772	Unavailable

**Credit Risk** - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The System's investment policy limits investments in domestic fixed-income securities; 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. As of year end, the credit quality ratings of debt securities are as follows:

Investment	Fair Value	Moody's
Asset-backed securities	\$ 2,412,328	Aaa
Asset-backed securities	194,987	Aa
Asset-backed securities	256,521	A
Asset-backed securities	2,132,877	Unrated
Commercial mortgage-backed securities	3,483,213	Aaa
Commercial mortgage-backed securities	1,703,558	Aa
Noncommercial mortgage-backed securities	3,729	A
Noncommercial mortgage-backed securities	69,745	Unrated
Corporate bonds	1,233,095	Aa
Corporate bonds	9,455,643	A
Corporate bonds	14,388,412	Baa
Corporate bonds	226,790	Ba
Corporate bonds	132,125	Unrated
Government agencies	939,836	Aaa
Government agencies	850,011	Aa
Government bonds	34,721,647	Aaa
Government mortgage backed	892,866	Unrated
Short-term investment funds	16,118,772	Unrated
Municipal/Provincial bonds	1,605,633	Aaa
Municipal/Provincial bonds	4,041,776	Aa
Municipal/Provincial bonds	5,083,038	Unrated

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### 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 pension system restricts the amount of investments in foreign currency-denominated investments to 10 percent of total pension system investments. At year end December 31, 2016, the only type of investments which were subject to foreign currency risk were equity investments. The total amount of equity investments which were subject to foreign currency risk at year end was \$21,127,079. At year end, the City of Pontiac General Employees' Retirement System had a total foreign currency translation loss of \$2,363,196 related to equity investments.

Security	Fair Market Value
Australian dollar	\$ 1,414,367
British pound	4,041,550
Canadian dollar	1,046,401
Denmark krone	2,682,464
European euro	4,935,889
Hong Kong dollar	1,280,517
Japanese yen	1,994,663
Mexican peso	463,410
South African rand	802,414
Swiss franc	2,465,404

### Note 4 - Fair Value Measurement

The System categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. Investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy below.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The System's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 4 - Fair Value Measurement (Continued)

The System has the following recurring fair value measurements as of December 31, 2016:

#### Assets Measured at Fair Value on a Recurring Basis

	Balance at December 31, 2016	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Debt securities:</b>				
U.S. Treasury securities	\$ 34,721,646	\$ -	\$ 34,721,646	\$ -
U.S. agencies	2,496,613	-	2,496,613	-
Municipal/Provincial	10,730,447	-	10,730,447	-
Commercial mortgage backed	5,260,245	-	5,260,245	-
Government issued commercial mortgage backed	1,422,032	-	1,422,032	-
U.S. government mortgage backed	14,427,481	-	14,427,481	-
Corporate bonds	25,436,065	-	25,436,065	-
Asset backed	4,996,713	-	4,996,713	-
Total debt securities	99,491,242	-	99,491,242	-
Equity securities - Common stock	282,318,729	282,318,729	-	-
Private equity funds	13,503,583	-	-	13,503,583
Total investments by fair value level	395,313,554	<u>\$ 282,318,729</u>	<u>\$ 99,491,242</u>	<u>\$ 13,503,583</u>
<b>Investments Measured at Net Asset Value (NAV)</b>				
International equities fund	36,506,477			
Global bond fund	17,874,092			
Total investments measured at NAV	54,380,569			
Total investments measured at fair value	<u>\$ 449,694,123</u>			

Debt securities fair value at December 31, 2016 was determined primarily based on Level 2 inputs. The fair value of these investments is based on prices that have been evaluated by independent pricing services. Such evaluated prices (which is the value of the bond less accrued interest) may be determined by using inputs such as interest rates and yield curves that are observable at commonly quoted intervals, maturities, call features, and ratings, among other factors.

# City of Pontiac General Employees' Retirement System

## Notes to Financial Statements December 31, 2016

### Note 4 - Fair Value Measurement (Continued)

The fair value of private equity investments at December 31, 2016 was determined primarily based on Level 3 inputs. The System estimates the fair value of these investments based on a review of an independent auditor's report for each fund and each fund's general partner's assessment of fair value. The general partner's estimates may include the use of pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the underlying assets. Currently, there remains \$3.8 million in unfunded commitments to these funds.

The valuation method for investments measured at the net asset value (NAV) per share (or its equivalent) is presented on the following table. The fair value at December 31, 2016 was determined based on the NAV per share of the System's ownership interest in the partners' capital.

#### Investments in Entities that Calculate Net Asset Value per Share

The System holds shares or interests in investment companies where the fair value of the investments are measured on a recurring basis using net asset value per share (or its equivalent) of the investment companies as a practical expedient.

At the year ended December 31, 2016, the fair value, unfunded commitments, and redemption rules of those investments is as follows:

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency, if Eligible</u>	<u>Redemption Notice Period</u>
International equities fund	\$ 36,506,477	\$ -	Monthly	10 Days
Global bond fund	<u>17,874,092</u>	<u>-</u>	Monthly	10 Days
Total investments measured at NAV	<u>\$ 54,380,569</u>	<u>\$ -</u>		

The international equities fund includes investments in mainly non-U.S. publicly traded equities. The fair values of the investments in this fund have been estimated using the net asset value per share of the investments.

The global bonds fund includes investments in investment grade fixed-income securities issued by U.S. and non-U.S. agencies and other governments, corporate, and other issuers. The fair values of the investments in this fund have been estimated using the net asset value per share of the investments.

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

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**Notes to Financial Statements  
December 31, 2016**

## **Note 4 - Fair Value Measurement (Continued)**

### **Disclosures Regarding Redemption Only Upon Liquidation**

The investments in private equity can never be redeemed with the funds. Instead, the nature of the investments in this type is that distributions are received through the liquidation of the underlying assets of the fund. If these investments were held, it is expected that the underlying assets of the fund would be liquidated over the next seven to ten years. However, as of December 31, 2016, it is probable that all of the investments of this type will be sold at an amount different from fair value.

## **Note 5 - Subsequent Events**

The City of Pontiac, Michigan (the plan sponsor) was experiencing significant financial difficulty. In early 2013, the City was in receivership under Michigan Public Act 436 of 2012. During this time, the retirees in the System lost their postretiree healthcare benefits. The elimination of the benefits were subsequently supplemented with a \$400 per month temporary increase in pension benefits through Ordinance number 2300 which is now superseded by Ordinance number 2337. This ordinance provides for this temporary increase in pensions through August 31, 2017.

On April 4, 2017, the City announced that a tentative settlement had been reached with regards to the retiree healthcare matter. This settlement agreement must be approved by various parties, including the City Council, Federal District Court, and IRS, among others. If fully approved, the settlement agreement would provide healthcare funding via the creation of a VEBA by utilizing certain overfunded assets from this System; therefore, if the changes are approved, the funded status of the System would decline. The System is currently significantly overfunded.

## **Required Supplemental Information**

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# City of Pontiac General Employees' Retirement System

## Required Supplemental Information Schedule of Changes in the Net Pension Liability and Related Ratios

Last Three Fiscal Years

(Schedule is built prospectively upon implementation of GASB  
Statement No. 67)

	2016	2015	2014
<b>Total Pension Liability</b>			
Service cost	\$ 324,671	\$ 301,489	\$ 279,188
Interest	17,944,933	19,232,034	19,973,828
Changes in benefit terms	-	5,407,365	-
Differences between expected and actual experience	5,189,027	(23,548,600)	(2,538,358)
Changes in assumptions	15,686,953	9,124,140	-
Benefit payments, including refunds	(27,119,534)	(28,052,593)	(27,494,450)
<b>Net Change in Total Pension Liability</b>	12,026,050	(17,536,165)	(9,779,792)
<b>Total Pension Liability - Beginning of year</b>	252,615,769	270,151,934	279,931,726
<b>Total Pension Liability - End of year</b>	<b>\$ 264,641,819</b>	<b>\$ 252,615,769</b>	<b>\$ 270,151,934</b>
<b>Plan Fiduciary Net Position</b>			
Contributions - Employer	\$ -	\$ -	\$ -
Contributions - Member	-	-	-
Net investment income	34,606,547	(3,414,613)	29,515,688
Administrative expenses	(683,083)	(954,593)	(784,783)
Benefit payments, including refunds	(27,119,534)	(28,052,593)	(27,494,450)
Other	5,748	37,358	17,453
<b>Net Change in Plan Fiduciary Net Position</b>	6,809,678	(32,384,441)	1,253,908
<b>Plan Fiduciary Net Position - Beginning of year</b>	459,342,354	491,726,795	490,472,887
<b>Plan Fiduciary Net Position - End of year</b>	<b>\$ 466,152,032</b>	<b>\$ 459,342,354</b>	<b>\$ 491,726,795</b>
<b>City's Net Pension Asset - Ending</b>	<b>\$ (201,510,213)</b>	<b>\$ (206,726,585)</b>	<b>\$ (221,574,861)</b>
<b>Plan Fiduciary Net Position as a Percentage of Total Pension Liability</b>	176.14 %	181.83 %	182.02 %
<b>Covered Employee Payroll</b>	\$ 1,540,472	\$ 1,528,731	\$ 1,478,241
<b>City's Net Pension Asset as a Percentage of Covered Employee Payroll</b>	(13,081.0)%	(13,512.0)%	(14,989.1)%

# City of Pontiac General Employees' Retirement System

## Required Supplemental Information Schedule of City Contributions Last Ten Fiscal Years

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Actuarially determined contribution	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Contributions in relation to the actuarially determined contribution	-	-	-	-	-	-	-	-	-	-
<b>Contribution Deficiency</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Covered Employee Payroll</b>	<b>\$ 1,540,472</b>	<b>\$ 1,528,731</b>	<b>\$ 1,478,241</b>	<b>\$ 1,574,964</b>	<b>\$ 2,742,912</b>	<b>\$ 3,968,743</b>	<b>\$ 9,493,229</b>	<b>\$14,414,481</b>	<b>\$14,414,486</b>	<b>\$13,559,473</b>
<b>Contributions as a Percentage of Covered Employee Payroll</b>	- %	- %	- %	- %	- %	- %	- %	- %	- %	- %

### Notes to Schedule of System Contributions

Actuarial valuation information relative to the determination of contributions:

Valuation date Actuarially determined contribution rates are calculated as of June 30, two and a half years prior to the end of the plan fiscal year in which the contributions are reported. Contributions for the City's fiscal year ended June 30, 2016 were determined based on the actuarial valuation as of December 31, 2013. The most recent valuation is as of December 31, 2016.

Methods and assumptions used to determine contribution rates are as follows:

Actuarial cost method	Entry age normal
Amortization method	Level dollar, open
Remaining amortization period	30 years
Asset valuation method	Market-value
Inflation	2.25 percent
Salary increases	3.60 percent - 7.40 percent (includes inflation)
Investment rate of return	7.00 percent
Retirement age	Age-based table of rates are specific to the type of eligibility condition
Mortality	The RP-2014 Healthy Annuitant Mortality Table (unadjusted) projected to 2021 using a static projection based on the two-dimensional MP-2014 improvement scales
Other information	Postretirement adjustment Hospital - No cost-of-living adjustment MAPE - 2.50 percent of original retirement income for 14 years, maximum of 35 percent PMEA - 2.00 percent of original retirement income for 14 years, maximum of 28 percent All others - 2.00 percent percent of original retirement income for 18 years, maximum of 36



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

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## **Required Supplemental Information Schedule of Investment Returns Last Three Fiscal Years (Schedule is Built Prospectively Upon Implementation of GASB Statement No. 67)**

	<u>2016</u>	<u>2015</u>	<u>2015</u>
Annual money weighted rate of return - Net of investment expense	7.79 %	(0.8)%	6.8 %

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

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## **Note to Pension Required Supplemental Information Schedules Year Ended December 31, 2016**

**Changes in Assumptions** - The System made the following assumption changes in fiscal year 2016:

1. The discount rate was decreased from 7.50 percent to 7.00 percent.
2. The mortality tables were adjusted. The System moved from using RP-2014 Blue Collar tables to RP-2014 Healthy Annuitant Mortality Table (unadjusted) projected to 2021 using a static projection based on the two-dimensional MP-2014 improvement scales.