
City of Pontiac Police and Fire Retiree Prefunded
Group Health and Insurance Trust

**Financial Report
with Supplemental Information
December 31, 2019**

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

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Independent Auditor's Report

To the Board of Trustees
City of Pontiac Police and Fire Retiree Prefunded
Group Health and Insurance Trust

Report on the Financial Statements

We have audited the accompanying basic financial statements of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") as of and for the year ended December 31, 2019 and the related notes to the financial statements, which collectively comprise the Trust'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.

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the fiduciary net position of the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust as of December 31, 2019 and the changes in its fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

To the Board of Trustees
City of Pontiac Police and Fire Retiree Prefunded
Group Health and Insurance Trust

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

September 14, 2020

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Management's Discussion and Analysis

Using This Annual Report

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

Condensed Financial Information

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

The Trust's Net Position

| | 2019 | 2018 |
|--|----------------------|----------------------|
| Assets | \$ 43,713,452 | \$ 40,039,724 |
| Liabilities | 264,566 | 193,530 |
| Net Position - Restricted for retiree health care | \$ 43,448,886 | \$ 39,846,194 |

The Trust's Changes in Net Position

| | 2019 | 2018 |
|---|----------------------|----------------------|
| Additions | | |
| Net investment income (loss) | \$ 6,263,203 | \$ (2,848,439) |
| Employer contributions | - | 4,073,975 |
| Other income | 3,081 | 29,049 |
| Total additions | 6,266,284 | 1,254,585 |
| Deductions | | |
| Retirees' health benefits - Net of retiree contribution | 2,614,513 | 2,304,955 |
| General and administrative expenses | 49,079 | 55,482 |
| Total deductions | 2,663,592 | 2,360,437 |
| Net Increase (Decrease) in Net Position | 3,602,692 | (1,105,852) |
| Net Position - Beginning of year | 39,846,194 | 40,952,046 |
| Net Position - End of year | \$ 43,448,886 | \$ 39,846,194 |

Plan Contributions

Employer contributions recognized were \$0 for 2019 and \$4,073,975 for 2018.

Retiree Health Benefits and Employee Contributions

Total retiree health benefits paid were \$3,264,577 and \$2,978,154 in 2019 and 2018, respectively, prior to the application of the portion of benefits to be paid by retirees. Retiree contributions were \$650,064 and \$673,199 in 2019 and 2018, respectively.

Overall Fund Structure and Objectives

The Trust exists to pay health care benefits to members retiring on or after August 22, 1996. Any excess of contributions over benefits paid will allow for additional funding to increase investment income to a level where the Trust will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Management's Discussion and Analysis (Continued)

Asset Allocation

The Trust 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 Trust. The following is a summary of the target asset allocation as of December 31, 2019:

| | |
|---|---------|
| Domestic equities | 52.50 % |
| Domestic fixed income | 15.00 |
| International equities and fixed income | 17.50 |
| Alternative assets | 15.00 |

Investment Results

The markets provided exceptionally strong returns to investors throughout 2019. The year started with the Federal Reserve offering a more accommodative stance, pushing interest rates lower and helping the equity markets rebound from a difficult end to 2018. Stocks suffered a couple setbacks during the second and third quarters, but generally ended those quarters in positive territory. The year ended with signs of a possible resolution to the trade war between the U.S. and China; the equity markets responded by setting new highs. Large caps posted the strongest gains (S&P 500: 31.5 percent in 2019); small caps and international equities endured larger losses during the sell-offs and lagged large caps (Russell 2000: 25.5 percent and MSCI EAFE: 22.0 percent in 2019). Fixed income enjoyed one of the best years in recent history as interest rates declined (BB US Aggregate: 8.7 percent in 2019). Real estate returns have moderated in recent years, generating results in the mid-single digits in 2019.

The Trust returned 18.09 percent for the year ended December 31, 2019 (gross return, measured using the time-weighted return on each component of the fund).

As described in Note 1, subsequent to December 31, 2019, the Trust's investment portfolio incurred a decline in fair value, consistent with the general decline in financial markets due to the COVID-19 pandemic. The long-term effects are unknown at this point. The Trust's total return must always be considered in a longer-term context. The Trust's investment horizon is long term, corresponding to the long-term nature of the Trust's liabilities. Therefore, the board of trustees establishes an asset allocation policy to control risks and generate expected returns that will enable the Trust 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 Trust over many years, not just one or two years.

Contacting the Trust's Management

This financial report is intended to provide a general overview of the Trust's finances and investment results in relation to actuarial projections. It shows the Trust'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 Trust's office at 700 Tower Drive, Suite 300, Troy, MI 48098.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Statement of Trust Net Position

December 31, 2019

Assets

| | |
|--|--------------|
| Cash and cash equivalents | \$ 1,911,489 |
| Investments: (Note 2) | |
| Short-term investments | 988,134 |
| Equities | 26,442,603 |
| Real estate investment trusts | 1,295,289 |
| U.S. government obligations and agencies | 1,122,881 |
| Mortgage-backed securities | 1,782,482 |
| Collateralized mortgage obligations | 303,714 |
| Asset-backed securities | 700,568 |
| Corporate bonds | 1,369,779 |
| Foreign bonds and notes | 122,316 |
| Limited partnerships | 6,472,695 |
| Contributions receivable (Notes 1 and 3) | 1,148,731 |
| Accrued interest and dividends | 52,771 |
| | <hr/> |
| Total assets | 43,713,452 |

Liabilities

| | |
|--|---------|
| Accounts payable | 39,343 |
| Due to City of Pontiac, Michigan | 72,778 |
| Due to City of Pontiac Police and Fire Retirement System | 85,754 |
| Due to brokers | 66,691 |
| | <hr/> |
| Total liabilities | 264,566 |

Net Position - Restricted for retiree health care

\$ 43,448,886

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Statement of Changes in Trust Net Position

Year Ended December 31, 2019

Additions

Investment income:

| | |
|---|------------------|
| Interest and dividends | \$ 770,628 |
| Net increase in fair value of investments | 5,647,904 |
| Investment-related expenses | <u>(155,329)</u> |

Total investment income 6,263,203

Other income 3,081

Total additions 6,266,284

Deductions

| | |
|---|---------------|
| Retirees' health benefits - Net of retiree contribution | 2,614,513 |
| General and administrative expenses | <u>49,079</u> |

Total deductions 2,663,592

Net Increase in Net Position 3,602,692

Net Position - Beginning of year 39,846,194

Net Position - End of year \$ 43,448,886

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 1 - Significant Accounting Policies

Reporting Entity

The City of Pontiac, Michigan (the "City") has established an irrevocable prefunded group health and insurance trust fund for health, optical, dental, and life insurance benefits for retirees who are members of the Police and Fire Retirement System of the City of Pontiac, Michigan and retired on or after August 22, 1996. During 2013, the board of trustees passed a resolution to expand membership to retirees who retired prior to August 22, 1996. The pre-August 22, 1996 retirees were covered by the Trust effective September 1, 2013 through April 1, 2014. All such benefits are paid out of the Trust. The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust (the "Trust") was created as an Internal Revenue Code 501(c)(9) Trust (VEBA). The Police and Fire Retirement System (the "Retirement System") performs the Trust's accounting function.

Plan Sponsor Financial Condition

The City of Pontiac, Michigan (the "plan sponsor") was experiencing 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. During 2012, the emergency manager issued Executive Orders S-206 and S-207. These orders required all retirees to enroll in Medicare upon reaching eligibility age. The orders also required pre-age 65 retirees to pay the amount of premium above the hard-cap limit established by Public Act 152 of 2011 or 20 percent of the annual rates, whichever is higher, effective July 1, 2012. The emergency manager subsequently issued Executive Order S-304, which stated that all of the City of Pontiac, Michigan's funding of health and prescription drug insurance for retirees be eliminated effective September 1, 2013 for the City's fiscal years ended June 30, 2014 and 2015.

As of the end of the fiscal year 2013, the City was no longer under receivership and was governed by a transition 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. Effective July 27, 2017, the City's receivership status was terminated.

Contributions that were scheduled to be made to the Trust for the years ended December 31, 2011 and 2010 in the amount of \$2,635,156 and \$2,104,382, respectively, were not remitted to the Trust by the City in those years. During 2011, the Trust filed a lawsuit against the plan sponsor to compel payment on past-due contributions. In March 2013, a settlement agreement was reached between the Trust and the plan sponsor, and the City remitted a payment for past-due contributions in the amount of \$3,243,923. Contributions for 2012 were also the subject of a separate lawsuit. On July 31, 2019, a court judgment was entered in favor of the Trust in the amount of \$4,073,975. To satisfy the judgment, the Trust is suspending its reimbursement made to the City each month for health care premium expenses until the judgment is fully satisfied. As of December 31, 2019, the remaining amount of \$1,148,731 has been reflected in the Trust's 2019 financial statements as a contribution receivable given these contributions are now due pursuant to legal requirements.

On April 4, 2017, the City of Pontiac, Michigan announced that a tentative settlement had been reached with regard to retiree health care. On November 19, 2018, the federal judge in the case approved the tentative settlement. This settlement agreement must yet be approved by various parties, including the Michigan Association of Public Employees (MAPE) and the Internal Revenue Service (IRS) among others. If fully approved by all parties, the settlement agreement would provide health care funding via the creation of a new VEBA by utilizing certain overfunded assets from the City of Pontiac General Employees' Retirement System and this Trust. The settlement agreement requires the City to apply for approval of this settlement with the IRS. As of the date of this report, the IRS letter was submitted and received qualification as tax exempt under Section 501(a).

December 31, 2019

Note 1 - Significant Accounting Policies (Continued)

Basis of Accounting

The City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust's financial statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due, and the employer has made a formal commitment and expressed intent to provide the contributions. Insurance and other benefit costs are recognized when due and payable in accordance with the terms of the Trust.

Use of Estimates

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

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 sale price at current exchange rates. Securities not traded on a national or international exchange are based upon quoted prices for comparable instruments with similar yields and risk in active and inactive markets. Investments that do not have an established market value are valued at net asset value (NAV) as a practical expedient to estimate fair value.

Subsequent Events

On March 11, 2020, the World Health Organization declared the outbreak of a respiratory disease caused by a new coronavirus a pandemic. First identified in late 2019 and now known as COVID-19, the large-scale pandemic has significantly impacted the global economy. As a result, the Trust's investment portfolio incurred a decline in fair value, consistent with the general decline in financial markets. However, because the values of individual investments fluctuate with market conditions and due to market volatility, the amount of losses that will be recognized in subsequent periods, if any, cannot be determined.

Note 2 - Deposits and Investments

A retiree health care fund is authorized by Michigan Public Act 314 of 1965, as amended (the "Act"), to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in mutual or commingled funds, but not the remainder of state statutory authority, as listed above. The Trust's deposits and investment policies are in accordance with statutory authority.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 2 - Deposits and Investments (Continued)

The Trust'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 Trust's deposits may not be returned to it. The Trust does not have a deposit policy for custodial credit risk. At year end, the Trust had \$1,913,310 of bank deposits (checking account) that were uninsured and uncollateralized. The Trust 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 Trust 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 Trust's investment policy does not restrict investment maturities.

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

| Investment | Fair Value | Weighted- average Maturity (Years) |
|-------------------------------------|------------|--|
| Corporate: | | |
| Asset backed | \$ 700,568 | 8.32 |
| Bonds | 1,369,779 | 6.17 |
| Collateralized mortgage obligations | 303,714 | 27.12 |
| Foreign bonds | 122,316 | 2.72 |
| U.S. government: | | |
| Mortgage backed | 1,782,482 | 26.10 |
| Treasuries, notes, and bonds | 1,122,881 | 6.78 |

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 2 - 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 Trust has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

| Investment | Carrying Value | Rating | Rating Organization |
|-------------------------------------|----------------|----------------|---------------------|
| Corporate: | | | |
| Asset-backed securities | \$ 245,312 | Aaa | Moody's |
| Asset-backed securities | 136,071 | Aa1 | Moody's |
| Asset-backed securities | 319,185 | Not rated | N/A |
| Bonds | 15,101 | Aa1 | Moody's |
| Bonds | 14,860 | Aa2 | Moody's |
| Bonds | 26,085 | A1 | Moody's |
| Bonds | 105,741 | A2 | Moody's |
| Bonds | 265,841 | A3 | Moody's |
| Bonds | 865,035 | Baa1 and below | Moody's |
| Bonds | 77,116 | Not rated | N/A |
| Collateralized mortgage obligations | 154,316 | Aaa | Moody's |
| Collateralized mortgage obligations | 34,735 | Aa1 | Moody's |
| Collateralized mortgage obligations | 73,356 | Aa2 | Moody's |
| Collateralized mortgage obligations | 41,307 | Aa3 | Moody's |
| Foreign bonds: | | | |
| Bonds | 31,484 | Aa2 | Moody's |
| Bonds | 30,203 | Aa3 | Moody's |
| Bonds | 30,372 | A2 | Moody's |
| Bonds | 30,257 | Baa1 and below | Moody's |

Fair Value Measurements

The Trust 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 net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy below.

In instances where 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 Trust'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 Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 2 - Deposits and Investments (Continued)

The Trust has the following recurring fair value measurements as of December 31, 2019:

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2019 |
|--|--|--|--|------------------------------------|
| Assets | | | | |
| Equity securities: | | | | |
| Common stock | \$ 26,442,603 | \$ - | \$ - | \$ 26,442,603 |
| Real estate investment trusts | 1,295,289 | - | - | 1,295,289 |
| Total equity securities | 27,737,892 | - | - | 27,737,892 |
| Debt securities: | | | | |
| U.S. government obligations and agencies | - | 1,122,881 | - | 1,122,881 |
| Mortgage-backed securities | - | 1,782,482 | - | 1,782,482 |
| Collateralized mortgage obligations | - | 303,714 | - | 303,714 |
| Asset-backed securities | - | 700,568 | - | 700,568 |
| Corporate bonds | - | 1,369,779 | - | 1,369,779 |
| Foreign bonds and notes | - | 122,316 | - | 122,316 |
| Total debt securities | - | 5,401,740 | - | 5,401,740 |
| Total investments by fair value | \$ 27,737,892 | \$ 5,401,740 | \$ - | 33,139,632 |
| Investments measured at NAV: | | | | |
| Bond fund | | | | 3,789,308 |
| Limited partnerships | | | | 2,683,387 |
| Total investments measured at NAV | | | | 6,472,695 |
| Total investments measured at fair value | | | | \$ 39,612,327 |

Equity securities classified in Level 1 are valued using prices quoted in active markets for those securities.

The fair value of debt securities at December 31, 2019 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 may be determined by using inputs, such as interest rates and yield curves, that are observable at commonly quoted intervals.

The Trust did not have any investments determined primarily based on Level 3 inputs at December 31, 2019.

The valuation method for investments measured at net asset value per share (or its equivalent) is presented in the table below.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 2 - Deposits and Investments (Continued)

Investments in Entities that Calculate Net Asset Value per Share

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

At December 31, 2019, the fair value, unfunded commitments, and redemption rules of those investments are as follows:

| | Carrying Value | Unfunded Commitments | Redemption Frequency, if Eligible | Redemption Notice Period |
|----------------------|----------------|----------------------|-----------------------------------|--------------------------|
| Bond fund | \$ 3,789,308 | \$ - | Monthly | 15 days |
| Limited partnerships | 2,683,387 | 292,048 | Quarterly | 10 days |

The bond fund is an investment in a fund that invests predominantly in U.S. and foreign government securities. The fair values of the investments in this fund have been estimated using net asset value per share of the investments.

The limited partnership class includes investments predominantly in private debt. The fair values of the investments in these funds have been estimated using net asset value per share of the investments.

In addition, the Trust has an investment of approximately \$988,134 reported at amortized cost in accordance with GASB Statement No. 79. This investment is not subject to any limitations or restrictions on withdrawals.

Note 3 - Postemployment Benefits

Plan Description

The City provides retiree health care benefits to eligible retirees and their spouses and qualified dependents through the City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust. This is a single-employer benefit plan administered by the City of Pontiac Police and Fire Retirement System.

Management of the Trust is vested in the board of trustees, which consists of five members - two trustees are elected by the membership, two sit by virtue of their position, and one is appointed by the other trustees.

The Trust's financial statements are also included in the City of Pontiac, Michigan's financial report and can be obtained by writing to 47450 Woodward Ave., Pontiac, MI 48342.

Benefits Provided

The Trust provides health, optical, dental, and life insurance benefits for retirees who are members of the Police and Fire Retirement System of the City of Pontiac and retired on or after August 22, 1996. During 2013, the board of trustees passed a resolution to expand membership to retirees who retired prior to August 22, 1996. The pre-August 22, 1996 retirees were covered by the Trust effective September 1, 2013 through April 1, 2014. All such benefits are paid out of the Trust.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 3 - Postemployment Benefits (Continued)

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. Prior to February 1, 2012, the Trust paid 100 percent of the costs of medical, hospitalization, disability, vision, hearing, and life insurance benefits for members of the VEBA, at a specific level of coverage, as set forth in the relevant collective bargaining agreements between the City of Pontiac, Michigan and the police and fire unions. The City of Pontiac's emergency manager issued Executive Orders 128 (Fire) and 131 (Police), effective February 1, 2012. These identical orders reduced the level of medical, hospitalization, and dental benefits. These orders eliminated coverage for life insurance, disability, vision, and hearing. Dental coverage was subsequently eliminated by executive order. The City of Pontiac, Michigan's emergency manager issued Executive Orders 206 (Fire) and 207 (Police), effective February 1, 2012. These identical orders required any current pre-age 65 retirees to pay by deduction from their pension checks the amount above the hard-cap limit (as defined in Public Act 152 of 2011) or 20 percent of the annual rates, whichever is higher.

The valuation is based on the level of benefits currently in place, as set forth by the above executive orders, not the collectively bargained benefits. The executive orders are temporary, pursuant to statute; therefore, when the State of Michigan determines that the City of Pontiac, Michigan's receivership has ended, the reduction in benefits as provided by these executive orders may be removed. In August 2017, the City was released from receivership; however, the decision to remove the reduction in benefits has not yet been made. If the valuation were based on the collectively bargained benefits, without reduction due to the executive orders, the OPEB liability would be higher, but that amount has not been calculated at this time.

Employees Covered by Benefit Terms

The following members were covered by the benefit terms:

| Date of member count | December 31, 2019 |
|---|-------------------|
| Inactive plan members or beneficiaries currently receiving benefits | 177 |
| Inactive plan members entitled to but not yet receiving benefits | 56 |
| Other retirees who could elect | 80 |

As of December 31, 2019, there were no active employees.

During 2011, a partial termination of the pension plan for police and fire employees was deemed to have occurred. This resulted from the termination of various active employee positions at the City under executive orders issued by the emergency manager. The impact of membership composition is reflected above, with the impact of the funded status of the health care trust being demonstrated below.

In addition, effective March 1, 2012, the remaining fire employees ceased to be employees of the City. As such, the plan is effectively closed for active or new participants.

Contributions

Historically, the Trust has been funded primarily by employer contributions. The trustees voted to implement funding at the actuarial recommended rate beginning on July 1, 2006. However, scheduled contributions were not paid to the Trust by the City. In the prior year, as described in Note 1, the Trust recorded a contribution receivable and corresponding revenue in the amount of \$4,073,975 related to a court judgment against the City in favor of the Trust. No contribution revenue was recorded in the current year.

Certain retirees are required to contribute toward the premiums paid on their behalf. Benefit expense for the year ended December 31, 2019 was \$2,614,513, which is net of \$650,064 in retiree contributions toward premiums.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 3 - Postemployment Benefits (Continued)

Net OPEB Asset

The net OPEB asset of the Trust has been measured as of December 31, 2019 and is composed of the following:

| | |
|---|-----------------------|
| Total OPEB liability | \$ 38,746,859 |
| Plan fiduciary net position | <u>43,448,886</u> |
| Net OPEB asset | <u>\$ (4,702,027)</u> |
| Plan fiduciary net position as a percentage of the total OPEB liability | 112.14 % |

Actuarial Assumptions

The total OPEB liability was determined by an actuarial valuation as of December 31, 2019. The valuation used the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

| | |
|-----------------------------|--|
| Inflation | 2.25 percent |
| Health care cost trend rate | 8.00 percent decreasing 0.5 percent per year to an ultimate rate of 5 percent for 2026 and later years |
| Mortality | General retirees and deferred vested employees: SOA Pub-2010 Headcount-weighted Public Safety Mortality Table fully generational using Scale MP-2019 |
| | Disabled retirees: SOA Pub-2010 Headcount-weighted Disabled Public Safety Mortality Table fully generational using Scale MP-2019 |
| | Surviving spouses: SOA Pub-2010 Headcount-weighted Contingent Survivor Mortality Table fully generational using Scale MP-2019 |
| Investment rate of return | 7.50 percent net of OPEB plan investment expense, including inflation |

Discount Rate

The discount rate used to measure the total OPEB liability at December 31, 2019 was 7.50 percent; however, the discount rate used to measure the total OPEB liability at the beginning of the year was 6.90 percent.

Based on those assumptions, the OPEB 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 OPEB liability.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 3 - Postemployment Benefits (Continued)

Investment Rate of Return

The long-term expected rate of return on OPEB 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. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

| Asset Class | Long-term Expected Real Rate of Return |
|----------------------|--|
| Domestic equity | 5.78 % |
| International equity | 7.06 |
| Domestic bonds | 2.03 |
| International bonds | 3.04 |
| Alternative assets | 5.58 |

Sensitivity of the Net OPEB Asset to Changes in the Discount Rate

The following presents the net OPEB asset of the Trust, calculated using the discount rate of 7.5 percent. The following also reflects what the Trust's net OPEB liability (asset) would be if it were calculated using a discount rate that is 1 percentage point lower (6.5 percent) or 1 percentage point higher (8.5 percent) than the current rate:

| | 1 Percentage Point Decrease (6.5%) | Current Discount Rate (7.5%) | 1 Percentage Point Increase (8.5%) |
|---|--|------------------------------------|--|
| Net OPEB liability (asset) of the Trust | \$ 814,285 | \$ (4,702,027) | \$ (9,181,378) |

Sensitivity of the Net OPEB Asset to Changes in the Health Care Cost Trend

The following presents the net OPEB asset of the Trust, calculated using the health care cost trend rate of 8.0 percent, as well as what the net OPEB (asset) liability would be if it were calculated using a health care cost trend rate that is 1 percentage point lower (7.0 percent) or 1 percentage point higher (9.0 percent) than the current rate:

| | 1 Percentage Point Decrease (7.0%) | Current Health Care Cost Trend Rate (8.0%) | 1 Percentage Point Increase (9.0%) |
|---|--|---|--|
| Net OPEB (asset) liability of the Trust | \$ (9,171,135) | \$ (4,702,027) | \$ 719,801 |

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Notes to Financial Statements

December 31, 2019

Note 3 - Postemployment Benefits (Continued)

Investment Policy

The Trust's policy with regard to the allocation of invested assets is established and may be amended by the Trust's board by a majority vote of its members. It is the policy of the Trust's board to pursue an investment strategy that manages risk through the prudent diversification of the portfolio across a broad selection of distinct asset classes. The Trust'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 Trust board's adopted asset allocation policy as of December 31, 2019:

| Asset Class | Target Allocation |
|----------------------|-------------------|
| Domestic equity | 52.50 % |
| International equity | 12.50 |
| Domestic bonds | 15.00 |
| International bonds | 5.00 |
| Alternative assets | 15.00 |

Rate of Return

For the year ended December 31, 2019, the annual money-weighted rate of return on OPEB plan investments, net of OPEB plan investment expense, was 18.42 percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Required Supplemental Information

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Required Supplemental Information Schedule of Changes in the Net OPEB (Asset) Liability and Related Ratios

| | Last Three Fiscal Years | | |
|--|-------------------------|----------------------|----------------------|
| | 2019 | 2018 | 2017 |
| Total OPEB Liability | | | |
| Interest | \$ 2,857,872 | \$ 2,983,381 | \$ 2,890,913 |
| Differences between expected and actual experience | (1,140,426) | (2,597,547) | 3,832,503 |
| Changes in assumptions | (3,059,994) | (2,409,464) | 551,988 |
| Benefit payments, including refunds | (2,614,513) | (2,304,955) | (1,887,615) |
| Net Change in Total OPEB Liability | (3,957,061) | (4,328,585) | 5,387,789 |
| Total OPEB Liability - Beginning of year | 42,703,920 | 47,032,505 | 41,644,716 |
| Total OPEB Liability - End of year | \$ 38,746,859 | \$ 42,703,920 | \$ 47,032,505 |
| Plan Fiduciary Net Position | | | |
| Contributions - Employer | \$ - | \$ 4,073,975 | \$ - |
| Net investment income (loss) | 6,263,203 | (2,848,439) | 4,508,528 |
| Administrative expenses | (49,079) | (55,482) | (95,449) |
| Benefit payments, including refunds | (2,614,513) | (2,304,955) | (1,887,615) |
| Other | 3,081 | 29,049 | 845 |
| Net Change in Plan Fiduciary Net Position | 3,602,692 | (1,105,852) | 2,526,309 |
| Plan Fiduciary Net Position - Beginning of year | 39,846,194 | 40,952,046 | 38,425,737 |
| Plan Fiduciary Net Position - End of year | \$ 43,448,886 | \$ 39,846,194 | \$ 40,952,046 |
| Net OPEB (Asset) Liability - Ending | \$ (4,702,027) | \$ 2,857,726 | \$ 6,080,459 |
| Plan Fiduciary Net Position as a Percentage of Total OPEB Liability | 112.14 % | 93.31 % | 87.07 % |

Contributions to the OPEB plan are not based on a measure of pay; therefore, no covered payroll is presented.

Schedule will be built prospectively from GASB Statement No. 74 adoption until 10 full years are presented.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Required Supplemental Information Schedule of OPEB Contributions

Last Ten Fiscal Years Years Ended December 31

| | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 |
|--|---------------------|--------------------|---------------------|---------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Actuarially determined contribution | \$ - | \$ 82,480 | \$ 287,012 | \$ 529,837 | \$ 5,079,102 | \$ 3,919,277 | \$ 5,663,685 | \$ 6,570,422 | \$ 6,598,669 | \$ 6,780,645 |
| Contributions in relation to the actuarially determined contribution | 2,925,244 | - | - | - | - | - | - | 3,243,332 | - | 3,158,681 |
| Contribution Excess (Deficiency) | \$ 2,925,244 | \$ (82,480) | \$ (287,012) | \$ (529,837) | \$ (5,079,102) | \$ (3,919,277) | \$ (5,663,685) | \$ (3,327,090) | \$ (6,598,669) | \$ (3,621,964) |

Based on the City's fiscal year ended June 30.

Amount shown as contributions for 2012 relate to contributions due during 2011 and 2010 that were received in 2012.

Amount shown as contributions for 2019 relate to the court judgment against the City for 2012 contributions, which was partially received in 2019.

Notes to Schedule of Contributions

Actuarial valuation information relative to the determination of contributions:

Valuation date Actuarially determined contribution rates are calculated as of June 30, two years prior to the end of the fiscal year in which the contributions are reported.

Methods and assumptions used to determine contribution rates:

| | |
|-------------------------------|--|
| Actuarial cost method | Entry age normal, level percent of salary |
| Amortization method | Level dollar |
| Remaining amortization period | 27 years |
| Asset valuation method | Market value |
| Inflation | 2.25 percent |
| Health care cost trend rates | 8.00 percent decreasing 0.5 percent per year to an ultimate rate of 5 percent for 2026 and later years |
| Investment rate of return | 7.5 percent |
| Mortality | Various SOA Pub-2010 headcount-weighted tables fully generational using Scale MP-2019 |

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Required Supplemental Information Schedule of OPEB Investment Returns

| | Last Three Fiscal Years | | |
|---|-------------------------|---------|---------|
| | 2019 | 2018 | 2017 |
| Annual money-weighted rate of return, net of investment expense | 18.42 % | (6.82)% | 12.43 % |

Schedule will be built prospectively from GASB Statement No. 74 adoption until 10 full years are presented.

City of Pontiac Police and Fire Retiree Prefunded Group Health and Insurance Trust

Note to Required Supplemental Information

December 31, 2019

Changes in Assumptions

In 2017, amounts reported as changes of assumptions resulted from adjustment of the discount rate from 7.10 percent to 6.50 percent.

In 2018, amounts reported as changes of assumptions resulted from adjustment of the discount rate from 6.50 percent to 6.90 percent.

In 2019, amounts reported as changes of assumptions resulted from adjustment of the discount rate from 6.90 percent to 7.50 percent and mortality table from the SOA RPH-2006 Total Dataset Mortality Table fully generational with SS 2018 improvement scale to various SOA Pub-2010 headcount-weighted tables fully generational using Scale MP-2019.