

**City of Kalamazoo, Michigan
Employees' Retirement System**

FINANCIAL STATEMENTS

December 31, 2012 and 2011

City of Kalamazoo, Michigan
Employees' Retirement System

TABLE OF CONTENTS

December 31, 2012 and 2011

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	i-ii
MANAGEMENT'S DISCUSSION AND ANALYSIS	iii-v
BASIC FINANCIAL STATEMENTS	
Statement of Plan Net Position	1
Statement of Changes in Plan Net Position	2
Notes to Financial Statements	3-8
REQUIRED SUPPLEMENTARY INFORMATION	
Schedule of Funding Progress	9
Schedule of Employer Contributions	10
OTHER SUPPLEMENTARY INFORMATION	
Schedule of Cash and Investments	11-13

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INDEPENDENT AUDITOR'S REPORT

To the Members of the Employees'
Retirement System Investment Committee
and the City Commission of Kalamazoo
Kalamazoo, Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Kalamazoo Employees' Retirement System (the System) as of and for the years then ended December 31, 2012 and 2011, and the related notes to the 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 misstatements 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.

Basis for Adverse Opinion

As discussed in Note B, the financial statements present only the City of Kalamazoo Employees' Retirement System. Accounting principles generally accepted in the United States of America require that City of Kalamazoo, Michigan's financial statements present the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Kalamazoo, Michigan.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion" paragraph, the financial statements referred to above do not present fairly, the financial position of the City of Kalamazoo, Michigan as of December 31, 2012, or the changes in financial position or cash flows thereof for the year then ended.

Unmodified Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Kalamazoo Employees' Retirement System as of December 31, 2012 and 2011, and the changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note H, during the year the System implemented GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. As a result of this implementation, the format and reporting of the financial statements has changed to reflect the required components of GASB Statement No. 63, as applicable. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and historical pension 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, who 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 supplementary 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City of Kalamazoo Employees' Retirement System's basic financial statements. The accompanying other supplementary information, as identified in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The schedule of cash and investments is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Abraham & Gaffney, P.C.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

June 27, 2013

City of Kalamazoo, Michigan
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2012 and 2011

The following is a discussion and analysis of the financial performance and position of the City of Kalamazoo Employees' Retirement System's ("The Retirement System"). It is intended to provide an overview of the Retirement Systems' financial activities for the fiscal year ended December 31, 2012. This analysis should be read in conjunction with the Independent Auditors Report and with the financial statements, which follows this section.

Condensed Financial Information

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

	Year Ended December 31,		
	2012	2011	2010
Total assets	\$ 532,184,534	\$ 483,052,598	\$ 511,299,405
Total liabilities	944,896	171,424	82,292
Net position held in trust for pension benefits	<u>\$ 531,239,638</u>	<u>\$ 482,881,174</u>	<u>\$ 511,217,113</u>
Net investment income (loss)	\$ 71,755,266	\$ (11,039,051)	\$ 76,195,624
Contributions:			
Plan members	1,199,113	1,519,670	1,689,077
Employer	905,746	-	-
Total additions	73,860,125	(9,519,381)	77,884,701
Pension benefits	24,886,037	18,140,577	16,976,057
Refund payments to terminated employees	181,872	249,948	164,360
Total benefits paid	25,067,909	18,390,525	17,140,417
General and administrative expenses	433,752	426,033	453,272
Total deductions from net position	25,501,661	18,816,558	17,593,689
Net increase (decrease) in net position held in trust	48,358,464	(28,335,939)	60,291,012
Net position held in trust for pension benefits			
Beginning of Year	<u>482,881,174</u>	<u>511,217,113</u>	<u>450,926,101</u>
End of Year	<u>\$ 531,239,638</u>	<u>\$ 482,881,174</u>	<u>\$ 511,217,113</u>
Ratio of benefits paid to contributions	1191%	1210%	1015%

City of Kalamazoo, Michigan
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2012 and 2011

Overall Fund Structure and Objectives

The Retirement System is a single-employer defined benefit contributory retirement plan. It was established to provide retirement, disability, and death benefits to city retirees and their beneficiaries. 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. Plan members are required to contribute 1.0% to 6.5% of their annual covered salary to the Retirement System, depending upon their bargaining unit. The City contributes such additional amounts, as necessary, based on actuarial determinations, to provide assets sufficient to pay for member benefits.

The City was not required to make a contribution for 2012 or 2011. The excess of benefits over contributions is funded through investment income. The Retirement System is authorized by the State's Pension Investment Act, as amended, to invest in common stocks, real estate, and various other obligations, subject to certain limitations.

Each year, an actuarial valuation of the Retirement System is completed. As of the December 31, 2012 actuarial report, the valuation of assets represents 120.1 percent of accrued liabilities. Last year the ratio was 133.9 percent. The decrease in overfunding is the result of the accrual of benefits during the year offset by the year's unfavorable experience.

Asset Allocation

It is the responsibility of the City of Kalamazoo Retirement Investment Committee (RIC) to recommend to the City Commission the investment policies and strategies, and retaining/monitoring the various investment managers, trustees, advisors, actuaries and other fiduciaries utilized by the Retirement System. The RIC determines the allocation of assets in accordance with allowable legal limits. In setting asset allocation policy, the RIC reviews the expected returns of various asset classes, the Plan's actuarial assumption rate, and the risks associated with alternative asset mix strategies. The RIC has established the following asset allocation:

<u>Asset Class</u>	<u>Target</u>
Micro Capitalization Domestic Equity	5%
Small Capitalization Domestic Equity	10%
Small Capitalization Value International Equity	10%
S&P Index Funds	30%
Large Capitalization Domestic Equity	5%
Emerging Markets Equity	10%
Intermediate Fixed Income	12.5%
Long Fixed Income	12.5%
Real Estate Securities	2.5%
Real Estate	2.5%

This asset allocation policy offers the optimal mix for meeting longer term goals at an acceptable level of risk. The asset classes stated above shall be further diversified (where possible) as to style and manager type to reduce risk further, while providing the opportunity for enhanced return. The Retirement System's investments are held in 10 portfolios administered by six investment managers.

City of Kalamazoo, Michigan
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2012 and 2011

Economic Factors, Investment Returns, and Other Important Matters

The global financial crisis of 2008 was followed by a fast and broad rebound of equities and fixed income securities. Because the stock market is the principal investment forum utilized by the Retirement System, the market's 2010 market rate of return had a positive impact on net assets.

In May and June of 2010, global markets were shaken badly by the sovereign debt crisis in Greece, and the potential repetition on a larger scale in Portugal, Spain, and even Great Britain, which caused retrenching mid-year in 2010.

However, markets recovered for the remainder of 2010, buoyed in part by a second round of "quantitative easing" by the Federal Reserve Bank in the form of roughly \$850 billion of purchases of U.S. government instrumentalities

In 2011 global markets experienced a deepening of negative investor sentiment based on the continuation of the sovereign debt crisis in Europe and the possible breakup of the European monetary system, the related exposure of the global banking system to asset losses and the potential for a worldwide credit crunch. The showdown over the U.S. federal budget in August 2011 also roiled markets badly for several months in the 3rd quarter.

In 2012, the broad U.S. stock market posted double-digit gains despite ongoing sovereign debt issues domestically and in Europe. All of the major U.S. stock indexes finished 2012 solidly in positive territory, successfully climbing what Wall Street dubs the "wall of worry" in the process, gaining \$2.1 trillion in paper assets, thanks in part to improvements in unemployment, which dropped to 7.7%, the lowest rate since October 2008. The first real signs of a sustainable recovery in the U.S. housing market emerged in 2012, and the European Central Bank managed to keep the Eurozone intact. The Federal Reserve restated its commitment near-zero short-term interest rates and Quantitative Easing measures until a more fundamental improvement in the job market emerged.

In 2012 the value of the Retirement System net assets held in trust for pension benefits increased by 10.01 percent, as compared to an decrease of 5.5 percent in 2011, and a increase of 13.4 percent in 2010. The increase in net assets held in trust for pension benefits can be attributed to a positive change in investment income during the year. In 2011, the System lost approximately \$11 million whereas in 2012 the System earned approximately \$72 million. Also, during 2012, the City voluntarily contributed \$905,746 which was not required by the actuarial assumptions.

It should also be noted that while the System recovered much of its earnings in 2012 this was partially offset by an increase in pension benefits paid from approximately \$18 million in 2011 to \$25 million in 2012. Pension benefits paid increased due to many employees participating in the City's Early Retirement Incentive program.

The Retirement System's purpose is to provide long-term benefit payments to its members and it is through long-term investing, as shown by the 25 year history of returns realized by the investments made by the RIC, that these promised benefits will be primarily funded. Through its investment policy asset allocation, the RIC has positioned the portfolio for this long-term investment objective.

In addition, to further maximize investment returns and preserve fund assets, the RIC carefully monitors the performance of each of its investment managers and takes the necessary corrective action to ensure acceptable investment results. To this end, the RIC voluntarily complies with the guidelines put forth by the Employee Retirement Income System Act (ERISA), which is designed to protect the interests of members and beneficiaries of pension systems.

Contacting the System's Financial Management

This financial report is designed to provide the public, citizens, and other interested parties with a general overview of the Retirement System's financial position. If you have questions about this report or need additional financial information, contact Thomas C. Skrobola, Director of Management Services, City of Kalamazoo, 241 W. South Street, Kalamazoo, MI 49007, (269) 337-8468.

City of Kalamazoo, Michigan
Employees' Retirement System

STATEMENT OF PLAN NET POSITION

December 31, 2012 and 2011

	2012	2011
ASSETS		
Cash and cash equivalents	\$ 3,480,386	\$ 2,445,025
Receivables		
Interest and dividends	1,178,827	925,647
Due from the City of Kalamazoo	838,570	-
Due from Metro Transit System	67,176	-
Total receivables	2,084,573	925,647
Investments, at fair value		
U.S. Treasuries	59,777,030	25,918,275
U.S. Agencies	7,300,373	8,999,428
Municipal securities	-	10,424
Corporate bonds	29,916,106	49,065,731
Collateralized mortgage obligations	27,322,399	36,259,992
Equity mutual funds	374,827,540	334,750,081
Real estate mutual funds	27,476,127	24,677,995
Total investments	526,619,575	479,681,926
Total assets	532,184,534	483,052,598
LIABILITIES		
Accounts payable	944,896	171,424
NET POSITION		
Restricted for pension benefits	\$ 531,239,638	\$ 482,881,174

See accompanying notes to financial statements.

City of Kalamazoo, Michigan
Employees' Retirement System

STATEMENT OF CHANGES IN PLAN NET POSITION

Years Ended December 31, 2012 and 2011

	2012	2011
ADDITIONS TO NET POSITION		
Investment income		
Change in fair value of investments	\$ 57,506,207	\$ (20,724,512)
Interest	3,513,418	4,255,505
Dividends	12,517,022	6,978,824
Total investment income	73,536,647	(9,490,183)
Less: investment expense	(1,781,381)	(1,548,868)
Net investment income	71,755,266	(11,039,051)
Contributions		
Employer	905,746	-
Plan members	1,199,113	1,519,670
Total contributions	2,104,859	1,519,670
Total additions to net position	73,860,125	(9,519,381)
DEDUCTIONS FROM NET POSITION		
Benefits	24,886,037	18,140,577
Refunds of contributions	181,872	249,948
Administrative expense	433,752	426,033
Total deductions from net position	25,501,661	18,816,558
CHANGE IN PLAN NET POSITION	48,358,464	(28,335,939)
Net position - beginning of year	482,881,174	511,217,113
Net position - end of year	\$ 531,239,638	\$ 482,881,174

See accompanying notes to financial statements.

City of Kalamazoo, Michigan
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

NOTE A: PLAN DESCRIPTION

The City of Kalamazoo Employees' Retirement System (the System) is a single-employer defined benefit contributory plan which provides pension, disability, and death benefits to all full-time employees and some part-time employees of the City of Kalamazoo (the City).

System membership consisted of the following at December 31, 2012 and 2011, according to actuarial valuations as of those dates:

	2012	2011
Retirees and beneficiaries receiving benefits	947	776
Terminated plan members entitled to, but not yet receiving, benefits	45	48
Active plan members	633	721
Total	1,625	1,545
Number of participating employers	1	1

Plan members are required to contribute between 1.0 to 6.5% of annual compensation to the System for pension benefits, depending on bargaining unit. The City is required to contribute such additional amounts, as necessary, based on actuarial determinations, to provide assets sufficient to pay for member benefits. No employer contributions were required for years ended December 31, 2012 and 2011, however in 2012 the City chose to contribute \$905,746.

The System is administered by the City of Kalamazoo Employees' Retirement System Pension Board of Trustees. Plan benefit provisions were established and may be amended under the authority of City Ordinances. Employee contribution requirements were established and may be amended subject to collective bargaining agreements and approval by the City Commission of the City of Kalamazoo.

NOTE B: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The System's more significant accounting policies are described below:

Reporting Entity - The accompanying financial statements are exclusive presentations of the financial condition and results of operations of the City of Kalamazoo Employees' Retirement System. The City of Kalamazoo is the plan sponsor of the City of Kalamazoo Employees' Retirement System. As a result, industry standards require the City to include the financial activities of the System in the City's Annual Financial Report. The Annual Financial Report of the City of Kalamazoo is available for public inspection at the Kalamazoo City Hall.

Basis of Accounting - 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. The City's contributions are recognized when due and the employer has made a formal commitment to provide them. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

City of Kalamazoo, Michigan
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

NOTE B: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Valuation of 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. Investments for which market quotations are not readily available are valued at their fair value as determined by the custodian under the direction of the Board with the assistance of a valuation service.

Administration - Administrative costs are financed through the System's investment earnings.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

NOTE C: DEPOSITS AND INVESTMENTS

Deposits

The System does not maintain any checking or other demand/time deposit accounts. Amounts reported as cash and cash equivalents in the statement of plan net assets include cash and short-term investments in money market accounts held by the System's investment managers. These accounts are insured by the Securities Investors Protection Corporation for up to \$500,000 each. The carrying amounts of these accounts as of December 31, 2012 and 2011 were \$3,480,386 and \$2,445,025, respectively, of which the insured amounts were \$1,763,216 and \$792,603, respectively. The remaining balances of \$1,717,170 and \$1,652,422, respectively, were uninsured and uncollateralized.

Investments

The Michigan Public Employees Retirement Systems' Investment Act, Public Act 314 of 1965, as amended, authorizes the System to invest in stocks, government and corporate securities, mortgages, real estate, and various other investment instruments, subject to certain limitations. The System's Investment Committee is responsible for recommending to the City Commission the investment policies and strategies, and retaining/monitoring the various investment managers, trustees, advisors, actuaries and other fiduciaries utilized by the System. The City Commission is responsible for approving the recommendations of the Investment Committee. All investment decisions are subject to Michigan law and the investment policy established by the City Commission.

City of Kalamazoo, Michigan
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED

The System's investments are held in ten (10) portfolios administered by five (5) investment managers. Following is a summary of the System's investments as of December 31:

	2012	2011
U.S. treasuries	\$ 59,777,030	\$ 25,918,275
U.S. agencies	7,300,373	8,999,428
Municipal securities	-	10,424
Corporate bonds	29,916,106	49,065,731
Collateralized mortgage obligations	27,322,399	36,259,992
Equity mutual funds	374,827,540	334,750,081
Real estate mutual funds	27,476,127	24,677,995
	\$ 526,619,575	\$ 479,681,926

Custodial Credit Risk

For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The System's investment policy does not address custodial credit risk. Although uninsured and unregistered, the System's investments are not exposed to custodial credit risk since the securities are held by the counterparty's trust department in the System's name. Short-term investments in money market funds and investments in mutual funds are not subject to custodial credit risk because their existence is not evidenced by securities that exist in physical or book form.

Credit Risk

The System's investment policy provides that its investments in bonds must be rated in the top four (4) major investment grades as determined by two nationally recognized statistical rating organizations. As of December 31, 2012 and 2011, the System's investments in fixed income securities were rated by Standard & Poor's and Moody's as follows:

	2012			2011			
	U.S. Agencies	Corporate Bonds	CMO	U.S. Agencies	Municipal Securities	Corporate Bonds	CMO
AAA	\$ -	\$ -	\$ 5,049,121	\$ -	\$ 10,424	\$ 3,420,454	\$ 2,251,214
AA	-	5,115,296	21,999,218	-	-	7,754,858	32,572,368
A	-	14,743,743	-	-	-	19,534,505	-
BBB	-	9,597,936	-	-	-	11,211,679	-
Not rated	7,300,373	459,131	274,060	8,999,428	-	7,144,235	1,436,410
	\$ 7,300,373	\$ 29,916,106	\$ 27,322,399	\$ 8,999,428	\$ 10,424	\$ 49,065,731	\$ 36,259,992
 <u>Moody's</u>							
AAA	\$ 166,574	\$ -	\$ 25,298,928	\$ 172,398	\$ 10,424	\$ 9,227,666	\$ 36,007,162
AA	-	4,093,694	-	-	-	8,827,435	-
A	-	10,202,751	-	-	-	16,299,698	-
BAA	-	14,361,307	-	-	-	13,357,679	-
Not rated	7,133,799	1,258,354	2,023,471	8,827,030	-	1,353,253	252,830
	\$ 7,300,373	\$ 29,916,106	\$ 27,322,399	\$ 8,999,428	\$ 10,424	\$ 49,065,731	\$ 36,259,992

City of Kalamazoo, Michigan
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED

Concentration of Credit Risk

The System's investment policy requires that the securities of any one company or government agency should not exceed 5% of the total fund. At December 31, 2012 and 2011, the System's investments were within that range.

The System's investment policy and State statutes provide that no more than 70% of the total investments may be in equity holdings and no more than 5% in real estate. As of December 31, 2012 and 2011, the System's equity holdings accounted for 71% and 70%, respectively, of the total investment portfolio; the System's holdings in real estate were 5% and 5% at December 31, 2012 and 2011.

Interest Rate Risk

For investments, the risk that changes in interest rates will adversely affect the fair value of the investment is known as interest rate risk. The System's investment policy does not address interest rate risk. As of December 31, 2012, and 2011, maturities of the System's debt securities were as follows:

<u>2012</u>	<u>Fair Value</u>	<u>Investment Maturities (fair value by years)</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>
U.S. Treasuries	\$ 59,777,030	\$ 20,344,186	\$ 6,599,950	\$ 5,177,311	\$ 27,655,583
U.S. Agencies	7,300,373	-	4,399,806	1,579,309	1,321,258
Corporate Bonds	29,916,106	459,131	8,825,257	10,186,769	10,444,949
Collateralized Mortgage Obligations	27,322,399	-	4,077,411	1,299,618	21,945,370
	<u>\$ 124,315,908</u>	<u>\$ 20,803,317</u>	<u>\$ 23,902,424</u>	<u>\$ 18,243,007</u>	<u>\$ 61,367,160</u>

<u>2011</u>	<u>Fair Value</u>	<u>Investment Maturities (fair value by years)</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>
U.S. Treasuries	\$ 25,918,275	\$ -	\$ 1,504,530	\$ 8,468,373	\$ 15,945,372
U.S. Agencies	8,999,428	-	2,253,786	4,702,980	2,042,662
Municipal Securities	10,424	-	10,424	-	-
Corporate Bonds	49,065,731	697,287	20,265,079	13,911,699	14,191,666
Collateralized Mortgage Obligations	36,259,992	-	1,537,591	5,001,666	29,720,735
	<u>\$ 120,253,850</u>	<u>\$ 697,287</u>	<u>\$ 25,571,410</u>	<u>\$ 32,084,718</u>	<u>\$ 61,900,435</u>

Derivatives

The System's investment policy permits the prudent use of derivatives to reduce portfolio risk and enhance investment return. Under the terms of the investment agreements, portfolio managers are required to report all derivative holdings on a quarterly basis. The Investment Committee monitors these reports to evaluate the System's exposure to credit, market and legal risk.

The portfolios managed by Jennison Associates have utilized U.S. currency futures contracts, a type of derivative, to reduce overall portfolio volatility caused by interest rate risk. At December 31, 2012 and 2011, the portfolio had no U.S. currency futures contracts.

City of Kalamazoo, Michigan
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

NOTE D: PENSION BENEFITS

During 2001, the City Ordinance was amended to provide for a supplemental benefits payment to certain retirees. Subject to certain limitations as described in the Ordinance, these payments may occur every third year commencing in 2001. Although the City could have made these payments in 2012, no amounts were paid in 2012. Also, no amounts were paid in 2011.

NOTE E: ADMINISTRATIVE AND INVESTMENT EXPENSES

The following provides additional details related to administrative expenses for the years ended December 31, 2012 and 2011:

	2012		2011	
	Amount	Percent of Net Assets	Amount	Percent of Net Assets
Investment advisor fees	\$ 1,781,381	0.335%	\$ 1,548,868	0.321%
Trust and custodial fees	189,819	0.036%	174,695	0.036%
Administrative expenses	243,933	0.046%	251,338	0.052%
	\$ 2,215,133		\$ 1,974,901	

NOTE F: RISK MANAGEMENT

The System is exposed to various risks of loss related to torts, errors and omissions. The System participates in the City of Kalamazoo's risk management program for all of these exposures. The City's risk management program is primarily a self-insured program with reinsurance amounts in excess of aggregate loss funds. The City estimates the liability for unpaid claims (including claims incurred but not reported) and allocates the cost to all appropriate entities and funds. There is no further exposure to the System that would require a liability to be recorded in the financial statements.

NOTE G: RETIREMENT PLAN

Annual Pension Cost

The City's pension costs were \$-0- and \$-0- and the actual contributions were \$905,746 and \$-0- for the periods ended December 31, 2012, and 2011, respectively. Contributions were made based on an actuarial valuations dated December 31, 2011, and December 31, 2010, respectively.

Actuarial Methods and Assumptions

The annual required contributions were determined as part of an actuarial valuations as of December 31, 2011, and December 31, 2010, using the individual entry-age normal cost method. Significant actuarial assumptions used include a 7.5 percent investment rate of return and projected salary increases ranging from 4.0 to 12.0 percent per year. An estimated rate of inflation of 4.0 percent which is included in both the investment rate of return and projected salary increases. The actuarial value of assets was determined by using the 5-year smoothed market value method. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis over the remaining amortization period of 10 years. Cost of living adjustments are determined annually.

City of Kalamazoo, Michigan
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

NOTE G: RETIREMENT PLAN - CONTINUED

Three (3) Year Trend Information

	Year Ended December 31,		
	2010	2011	2012
Actuarial value of assets	\$ 518,339,022	\$ 509,931,421	\$ 505,234,953
Actuarial accrued liabilities (AAL) (entry age)	367,423,522	380,802,126	420,711,365
Unfunded AAL (UAAL)	(150,915,500)	(129,129,295)	(84,523,588)
Funded ratio	141.1%	133.9%	120.1%
Covered payroll	43,007,800	42,305,663	36,538,969
UAAL as a percentage of covered payroll	-350.9%	-305.2%	-231.3%
Annual pension cost (APC)	-	-	-
Percentage of APC contributed	100%	100%	100%

The schedules of funding progress and employer contributions, presented as required supplementary information (RSI) following the notes to the financial statements, present multi-year trend information about amounts contributed and whether the actuarial values of plan assets are increasing or decreasing over time relative to the AALs for benefits.

NOTE H: DEFERRED INFLOWS AND OUTFLOWS OF RESOURCES

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, was implemented in the current period. This statement incorporates deferred outflows of resources and deferred inflows of resources, as defined by GASB Concepts Statement No. 4, into the definitions of the required components of the residual measure of net position, formerly net assets. The Statement of Net Position reports the following components: assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position.

NOTE I: UPCOMING ACCOUNTING PRONOUNCEMENTS

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The statement will be effective for the System's fiscal year ended December 31, 2013. The Statement establishes accounting and financial reporting standards that reclassify as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statements elements deferred outflows of resources and deferred inflows of resources. The Fund is currently evaluating the impact this standard will have on the financial statements when adopted.

In June 2012, the GASB issues Statement No. 67, *Financial Reporting for Pension Plans*. The statement will be effective for the System's 2014 fiscal year. The statement will establish accounting and financial reporting requirements related to defined benefit plans and specify the required approach to measuring the pension liability of employers. The statement also enhances accountability and transparency through revised note disclosures and required supplementary information (RSI). The System is currently evaluating the impact this standard will have on the financial statements when adopted.

REQUIRED SUPPLEMENTARY INFORMATION

City of Kalamazoo, Michigan
Employees' Retirement System

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	(Overfunded) AAL (OAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	OAAL as a Percentage of Covered Payroll [(b-a)/c]
12/31/2012	\$ 505,234,953	\$ 420,711,365	\$ (84,523,588)	120.1%	\$ 36,538,969	-231.3%
12/31/2011	509,931,421	380,802,126	(129,129,295)	133.9%	42,305,663	-305.2%
12/31/2010	518,339,022	367,423,552	(150,915,470)	141.1%	43,007,800	-350.9%
12/31/2009	509,060,409	358,160,400	(150,900,009)	142.1%	44,435,753	-339.6%
12/31/2008	506,592,573	344,799,153	(161,793,420)	146.9%	44,159,590	-366.4%
12/31/2007	500,788,244	327,242,870	(173,545,374)	153.0%	42,889,419	-404.6%
12/31/2006	463,280,966	312,101,938	(151,179,028)	148.4%	42,164,958	-358.5%
12/31/2005	422,565,761	294,416,007	(128,149,754)	143.5%	40,944,435	-313.0%
12/31/2004	390,615,277	265,080,190	(125,535,087)	147.4%	41,989,819	-299.0%
12/31/2003	361,205,383	245,919,424	(115,285,959)	146.9%	40,914,264	-281.8%
12/31/2002	348,677,897	230,979,927	(117,697,970)	151.0%	40,316,918	-291.9%
12/31/2001	349,206,708	220,302,430	(128,904,278)	158.5%	41,595,437	-309.9%

City of Kalamazoo, Michigan
Employees' Retirement System

SCHEDULE OF EMPLOYER CONTRIBUTIONS

<u>Year Ended December 31,</u>	<u>Annual Required Contribution</u>	<u>Annual Actual Contribution</u>	<u>Percentage Contribution</u>
2012	\$ -	\$ 905,746	N/A
2011	-	-	N/A
2010	-	-	N/A
2009	-	-	N/A
2008	-	-	N/A
2007	-	-	N/A
2006	-	-	N/A
2005	-	-	N/A
2004	-	-	N/A
2003	-	-	N/A
2002	-	-	N/A
2001	-	-	N/A

OTHER SUPPLEMENTARY INFORMATION

City of Kalamazoo, Michigan
Employees' Retirement System

SCHEDULE OF CASH AND INVESTMENTS

December 31, 2012 and 2011

	Barclays Global Investors		Jennison Associates	
	Fair Value	Cost	Fair Value	Cost
<u>December 31, 2012</u>				
Cash and cash equivalents	\$ 41	\$ 41	\$ 2,217,170	\$ 2,217,170
Investments				
U.S. treasuries	-	-	59,777,030	59,065,217
U.S. agencies	-	-	7,300,373	6,084,643
Corporate bonds	-	-	29,916,106	27,287,183
Collateralized mortgage obligations	-	-	27,322,399	27,136,585
Equity mutual funds	158,458,513	65,949,758	-	-
Real estate mutual funds	-	-	-	-
Total investments	<u>158,458,513</u>	<u>65,949,758</u>	<u>124,315,908</u>	<u>119,573,628</u>
Total cash and investments	<u>\$ 158,458,554</u>	<u>\$ 65,949,799</u>	<u>\$ 126,533,078</u>	<u>\$ 121,790,798</u>
<u>December 31, 2011</u>				
Cash and cash equivalents	\$ 41	\$ 41	\$ 2,152,422	\$ 2,152,422
Investments				
U.S. treasuries	-	-	25,918,275	24,112,697
U.S. agencies	-	-	8,999,428	7,654,082
Municipal securities	-	-	10,424	10,678
Corporate bonds	-	-	49,065,731	47,876,148
Collateralized mortgage obligations	-	-	36,259,992	35,515,429
Equity mutual funds	144,433,804	69,769,395	-	-
Real estate mutual funds	-	-	-	-
Total investments	<u>144,433,804</u>	<u>69,769,395</u>	<u>120,253,850</u>	<u>115,169,034</u>
Total cash and investments	<u>\$ 144,433,845</u>	<u>\$ 69,769,436</u>	<u>\$ 122,406,272</u>	<u>\$ 117,321,456</u>

Dimensional Fund Advisors, Inc.		RREEF		Master Account	
Fair Value	Cost	Fair Value	Cost	Fair Value	Cost
\$ -	\$ -	\$ -	\$ -	\$ 1,263,175	\$ 1,263,175
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
216,369,027	188,130,686	-	-	-	-
-	-	27,476,127	27,867,711	-	-
<u>216,369,027</u>	<u>188,130,686</u>	<u>27,476,127</u>	<u>27,867,711</u>	<u>-0-</u>	<u>-0-</u>
<u>\$ 216,369,027</u>	<u>\$ 188,130,686</u>	<u>\$ 27,476,127</u>	<u>\$ 27,867,711</u>	<u>\$ 1,263,175</u>	<u>\$ 1,263,175</u>
\$ -	\$ -	\$ -	\$ -	\$ 292,562	\$ 292,562
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
-	-	-	-	-	-
190,316,277	189,214,260	-	-	-	-
-	-	24,677,995	27,521,721	-	-
<u>190,316,277</u>	<u>189,214,260</u>	<u>24,677,995</u>	<u>27,521,721</u>	<u>-0-</u>	<u>-0-</u>
<u>\$ 190,316,277</u>	<u>\$ 189,214,260</u>	<u>\$ 24,677,995</u>	<u>\$ 27,521,721</u>	<u>\$ 292,562</u>	<u>\$ 292,562</u>

City of Kalamazoo, Michigan
Employees' Retirement System

SCHEDULE OF CASH AND INVESTMENTS - CONTINUED

December 31, 2012 and 2011

	Total	
	Fair Value	Cost
<u>December 31, 2012</u>		
Cash and cash equivalents	\$ 3,480,386	\$ 3,480,386
Investments		
U.S. treasuries	59,777,030	59,065,217
U.S. agencies	7,300,373	6,084,643
Corporate bonds	29,916,106	27,287,183
Collateralized mortgage obligations	27,322,399	27,136,585
Equity mutual funds	374,827,540	254,080,444
Real estate mutual funds	27,476,127	27,867,711
Total investments	526,619,575	401,521,783
Total cash and investments	\$ 530,099,961	\$ 405,002,169
 <u>December 31, 2011</u>		
Cash and cash equivalents	\$ 2,445,025	\$ 2,445,025
Investments		
U.S. treasuries	25,918,275	24,112,697
U.S. agencies	8,999,428	7,654,082
Municipal securities	10,424	10,678
Corporate bonds	49,065,731	47,876,148
Collateralized mortgage obligations	36,259,992	35,515,429
Equity mutual funds	334,750,081	258,983,655
Real estate mutual funds	24,677,995	27,521,721
Total investments	479,681,926	401,674,410
Total cash and investments	\$ 482,126,951	\$ 404,119,435