

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

**FINANCIAL STATEMENTS**

**December 31, 2018 and 2017**

City of Kalamazoo, Michigan  
Employees' Retirement System

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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 statements of plan net position of the City of Kalamazoo Employees' Retirement System (the System), as of December 31, 2018, and the related statements of changes in plan net position for the year then ended, 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.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net position of the City of Kalamazoo Employees' Retirement System as of December 31, 2018, and the respective changes in its plan net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of a Matter***

As discussed in Note B, the financial statements present only the City of Kalamazoo Employees' Retirement System and do not purport to, and do not present fairly the financial position of the City of Kalamazoo, Michigan, as of December 31, 2018 and 2017, and the changes in its financial position for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

***Report on Comparative Information***

The comparative information presented herein as of and for the year ended December 31, 2017, was derived from financial statements that were audited by other auditors whose report dated June 27, 2018 expressed an unmodified opinion on those statements.

***Other Matter***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and schedules of 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.

*Manes Costeiran PC*

June 28, 2019

City of Kalamazoo, Michigan  
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2018 and 2017

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, 2018 and 2017. This analysis should be read in conjunction with the Independent Auditor's 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,		
	2018	2017	2016
Total assets	\$ 594,407,875	\$ 671,009,854	\$ 634,781,714
Total liabilities	36,462	81,894	21,754,339
Net position held in trust for pension benefits	<u>\$ 594,371,413</u>	<u>\$ 670,927,960</u>	<u>\$ 613,027,375</u>
Net investment income (loss)	\$ (47,440,721)	\$ 94,301,279	\$ 72,939,990
Contributions:			
Plan members	1,209,623	1,086,258	1,085,940
Employer	-	-	-
Total additions (reductions)	(46,231,098)	95,387,537	74,025,930
Pension benefits	29,858,901	28,407,023	28,474,218
Refund payments to terminated employees	72,516	84,357	22,652
Total benefits paid	29,931,417	28,491,380	28,496,870
General and administrative expenses	394,032	379,630	328,746
Total deductions from net position	30,325,449	28,871,010	28,825,616
Special item	-	(8,615,942)	(21,700,000)
Net increase (decrease) in net position held in trust	(76,556,547)	57,900,585	23,500,314
Net position held in trust for pension benefits			
Beginning of Year	<u>670,927,960</u>	<u>613,027,375</u>	<u>589,527,061</u>
End of Year	<u>\$ 594,371,413</u>	<u>\$ 670,927,960</u>	<u>\$ 613,027,375</u>

**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.

City of Kalamazoo, Michigan  
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MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2018 and 2017

The City was not required to make a contribution for 2018 or 2017. 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, 2018, actuarial report, the valuation of assets represents 134.7% of accrued liabilities. Last year the ratio was 136.8%. The decrease in overfunding is primarily due to unfavorable asset 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	5.00%
Small Capitalization Domestic Equity	10.00%
Small Capitalization Value International Equity	10.00%
S&P Index Funds	30.00%
Large Capitalization Domestic Equity	5.00%
Emerging Markets Equity	10.00%
Intermediate Fixed Income	12.50%
Long Fixed Income	12.50%
Real Estate Securities	2.50%
Real Estate	2.50%

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 nine portfolios administered by five investment managers.

**Economic Factors, Investment Returns, and Other Important Matters**

The Retirement System's purpose is to provide long-term benefit payments to its members. It is through long-term investing, as shown by the 30 year history of returns realized by the investment strategy of the Retirement Investment Committee (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. There are no major changes to the investment strategy for 2019.

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.

City of Kalamazoo, Michigan  
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MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2018 and 2017

The City's Group Trust contains the City's Pension, the Central County Transportation Authority's (CCTA) Pension, and OPEB investment assets. Global markets experienced extreme volatility in 2018, ending in a down year for both stocks and bonds, resulting in declines in annual returns. The investment portfolio for the City's Pension Plan reported a net return of -7.36% for fiscal year 2018, which was a sharp decrease from the 15.83% net return in 2017. Equities provided the greatest loss, returning -10.56% for the year, while Fixed Income returned a loss of -.04%, and Real Estate had a modest return of .86%. The net position of the System at year end was approximately \$594 million, a decrease of \$76.5 million from fiscal year 2017.

**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 Steve Vicenzi, Director of Management Services, City of Kalamazoo, 241 W. South Street, Kalamazoo, MI 49007, (269) 337-8336.

City of Kalamazoo, Michigan  
Employees' Retirement System

STATEMENTS OF PLAN NET POSITION

December 31, 2018 and 2017

	2018	2017
<b>ASSETS</b>		
Cash and cash equivalents	\$ 239,863	\$ 350,464
Receivables		
Interest and dividends	994,799	1,065,546
Investments sold	244,354	1,683,421
Total receivables	1,239,153	2,748,967
Investments, at fair value		
U.S. Treasuries	75,405,975	81,536,908
U.S. Agencies	-	1,457,997
Corporate bonds	56,982,274	59,161,242
Collateralized mortgage obligations	18,182,557	17,794,110
Equity mutual funds	410,847,485	475,535,176
Real estate mutual funds	31,510,568	32,424,990
Total investments	592,928,859	667,910,423
Total assets	594,407,875	671,009,854
<b>LIABILITIES</b>		
Accounts payable	36,462	81,894
<b>NET POSITION</b>		
Net position restricted for pension benefits	\$ 594,371,413	\$ 670,927,960

See accompanying notes to financial statements.

City of Kalamazoo, Michigan  
Employees' Retirement System

STATEMENTS OF CHANGES IN PLAN NET POSITION

Years Ended December 31, 2018 and 2017

	2018	2017
<b>ADDITIONS TO NET POSITION</b>		
Investment income (loss)		
Change in fair value of investments	\$ (64,225,595)	\$ 76,768,193
Interest	4,332,651	4,177,224
Dividends	14,655,560	15,476,424
Total investment income (loss)	(45,237,384)	96,421,841
Less: investment expense	(2,203,337)	(2,120,562)
Net investment income (loss)	(47,440,721)	94,301,279
Contributions		
Plan members	1,209,623	1,086,258
Total additions (reductions) to net position	(46,231,098)	95,387,537
<b>DEDUCTIONS FROM NET POSITION</b>		
Benefits	29,858,901	28,407,023
Refunds of contributions	72,516	84,357
Administrative expenses	147,100	147,099
Other expenses	246,932	232,531
Total deductions from net position	30,325,449	28,871,010
<b>SPECIAL ITEM</b>		
Transfer of assets to other governmental unit	-	(8,615,942)
<b>CHANGE IN PLAN NET POSITION</b>	(76,556,547)	57,900,585
Net position - beginning of year	670,927,960	613,027,375
Net position - end of year	\$ 594,371,413	\$ 670,927,960

See accompanying notes to financial statements.

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE A: PLAN DESCRIPTION**

Plan Administration

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, Michigan (the City).

The System is administered by the City of Kalamazoo Employees' Retirement System Pension Board of Trustees. The Board consists of five (5) individual trustees either elected or appointed in accordance with the City Ordinance. One (1) member is a City Commissioner and one (1) member is the City Manager. The remaining three (3) members, including one (1) Public Safety representative and one (1) General Member representative, are elected by active members of the retirement system. All elected terms are three (3) years. The 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.

Plan Membership

System membership consisted of the following at December 31, 2018 and 2017, according to actuarial valuations as of those dates:

	2018	2017
Retirees and beneficiaries receiving benefits	903	911
Terminated plan members entitled to, but not yet receiving, benefits	66	54
Active plan members	573	572
Total	1,542	1,537
Number of participating employers	1	1

Benefits Provided

The System provides retirement, death and disability benefits to plan members and their beneficiaries as follows:

Regular retirement - General members are eligible for benefits at age 57 with 25 or more years of service or age 62 with 10 or more years of service. American Federation of State, County and Municipal Employees (AFSCME) members are eligible for benefits at age 60 with 20 or more years of service. Exempt members are eligible for benefits at age 62 with 5 years of service. Public safety members are eligible for benefits with 25 years of service or at age 50 with 10 or more years of service. Retirement benefits are calculated as final average compensation (highest 3 consecutive years out of the last 10) times 2.1% for each year of service for general plan members, Kalamazoo Municipal Employee's Association (KMEA) members, and AFSCME members, 2.3% for each year of service for exempt members and 2.7% for each year of service for the City manager and public safety members. The maximum benefit is 70.2% of final average compensation for public safety members.

Early retirement - General members are eligible for benefits at age 55 with 15 or more years of service. Public safety members are eligible for benefits with 20 years of service. Retirement benefits are calculated as regular retirement but reduced by 4/10 of 1% for each month and fraction of a month by which retirement precedes age 62 if less than 25 years of service or age 57 if 25 or more years of service for general plan members and 2% of final average compensation multiplied by years of credited service for public safety members.

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE A: PLAN DESCRIPTION - CONTINUED**

Benefits Provided - continued

Deferred retirement - Members are eligible for benefits with 10 years of service for most members, 5 years for exempt members, 9 years for AFSCME members hired before October 2, 2016, and 8 years for KMEA members hired before January 1, 2009. Benefits begin at age 62 for general members, and at age 50 for public safety members. Retirement benefits are calculated as regular or early retirement but based upon service and final average compensation at termination date for general members as early retirement for public safety members.

Death and disability - Members are eligible for benefits, in accordance with plan provisions, after 10 years of service for most members, 5 years for exempt members, 9 years for AFSCME members hired before October 2, 2016, and 8 years for KMEA members hired before January 1, 2009. Service requirements are waived for duty disability and death benefits.

Benefit terms provide for annual cost-of-living adjustments to each member's retirement allowance subsequent to the member's retirement date. Pensions of AFSCME members who retire on or after October 25, 1999, are increased 1% per year, compounded annually, beginning 1 year after retirement and 2% per year, compounded annually, beginning at age 75. Pensions of KMEA members are increased 1.5% per year, compounded annually, beginning the latter of the retirees' 64<sup>th</sup> birthday and 1 year after retirement and 2% per year, compounded annually, beginning at age 75. Pensions of public safety members who retire on and after January 1, 1995, with 25 or more years of service, are increased 2% per year, compounded annually. Pensions of exempt members are increased 1.5% per year, compounded annually, beginning 1 year after retirement for members who elected to contribute by May 2006. Pensions of the City manager are increased 2% per year, compounded annually.

Deferred Retirement Option Program

Public safety administrators meeting relevant provisions for an unreduced retirement allowance, authorization by the City Manager, and approval of the City Commission are eligible for the deferred retirement option program (DROP). The annual benefit is computed as regular retirement but is frozen at date of DROP election. For the year ended December 31, 2018, the balance of amounts held by the Plan pursuant to the DROP is \$56,687.

Contributions

System 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, 2018 and 2017.

**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, 2018 and 2017

**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.

The investments of the System are pooled with those of the City's Other Post-Employment Benefits (OPEB) Trust and the Central County Transportation Authority (CCTA). The purchases, maturities, and investment performance are allocated between the System, the OPEB Trust fund, and the CCTA based on the fair value of their respective investments. As of December 31, 2018, and 2017, the System's investments represented approximately 83.0% and 82.9% of the portfolio, respectively.

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 statements of plan net position 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 balances of these accounts as of December 31, 2018 and 2017, were \$239,863 and \$350,464, respectively. These amounts were fully insured as of December 31, 2018 and 2017, respectively.

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, 2018 and 2017

**NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED**

Investments - continued

The adopted asset allocation policy as of December 31, 2018 and 2017, was as follows:

<u>Asset Class</u>	<u>Target</u>	<u>Long Term Expected Rate of Return</u>
Micro Capitalization Domestic Equity	5.00%	4.60%
Small Capitalization Domestic Equity	10.00%	4.60%
Small Capitalization Value International Equity	10.00%	4.10%
S&P Index Funds	30.00%	4.10%
Large Capitalization Domestic Equity	5.00%	4.20%
Emerging Markets Equity	10.00%	6.60%
Intermediate Fixed Income	12.50%	1.00%
Long Fixed Income	12.50%	1.00%
Real Estate Securities	2.50%	2.90%
Real Estate	2.50%	2.90%

The System's investments are held in nine (9) portfolios administered by five (5) investment managers. Following is a summary of the System's investments as of December 31:

	<u>2018</u>	<u>2017</u>
U.S. Treasuries	\$ 75,405,975	\$ 81,536,908
U.S. Agencies	-	1,457,997
Corporate bonds	56,982,274	59,161,242
Collateralized mortgage obligations	18,182,557	17,794,110
Equity mutual funds	410,847,485	475,535,176
Real estate mutual funds	31,510,568	32,424,990
Total investments	<u>\$ 592,928,859</u>	<u>\$ 667,910,423</u>

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy is also established which requires an entity to maximize the use of observable and minimize the use of unobservable inputs.

There are three (3) levels of inputs that may be used to measure fair value:

- Level 1: Quoted prices in active markets for identical securities.
- Level 2: Prices determined using other significant observable inputs. Observable inputs are inputs that other market participants may use in pricing a security. These may include quoted prices for similar securities, interest rates, prepayment speeds, credit risk and others.
- Level 3: Prices determined using significant unobservable inputs. Unobservable inputs may be used in situations where quoted prices or observable inputs are unavailable or deemed less relevant (for example, when there is little or no market activity for an investment at the end of the period). Unobservable inputs reflect the organization's own assumptions about the factors market participants would use in pricing an investment and would be based on the best information available.

City of Kalamazoo, Michigan  
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NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED**

Fair Value Measurements - continued

As of December 31, 2018 and 2017, the carrying amounts and fair values for each investment are as follows:

<u>2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Federal Home Loan	\$ 123,556	\$ -	\$ -	\$ 123,556
Fannie Mae	18,059,001	-	-	18,059,001
U.S. Treasury Notes	75,405,975	-	-	75,405,975
Corporate Bonds	-	56,982,274	-	56,982,274
Equity mutual funds	410,847,485	-	-	410,847,485
Real estate mutual funds	31,510,568	-	-	31,510,568
	<u>\$ 535,946,585</u>	<u>\$ 56,982,274</u>	<u>\$ -0-</u>	<u>\$ 592,928,859</u>
<u>2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
U.S. Strips	\$ 1,457,997	\$ -	\$ -	\$ 1,457,997
Federal Home Loan	149,931	-	-	149,931
Fannie Mae	17,644,179	-	-	17,644,179
U.S. Treasury Notes	81,536,908	-	-	81,536,908
Corporate Bonds	-	59,161,242	-	59,161,242
Equity mutual funds	475,535,176	-	-	475,535,176
Real estate mutual funds	32,424,990	-	-	32,424,990
	<u>\$ 608,749,181</u>	<u>\$ 59,161,242</u>	<u>\$ -0-</u>	<u>\$ 667,910,423</u>

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.

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED**

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, 2018 and 2017, the System's investments in fixed income securities were rated by Standard & Poor's and Moody's as follows:

Standard & Poor's	2018		U.S. Agencies	2017	
	Corporate Bonds	CMO		Corporate Bonds	CMO
AAA	\$ 7,494,195	\$ -	\$ -	\$ 4,536,365	\$ -
AA	7,856,237	18,182,557	-	6,188,174	17,794,110
A	19,787,715	-	-	28,152,761	-
BBB	20,776,426	-	-	19,759,854	-
Not rated	1,067,701	-	1,457,997	524,088	-
	<u>\$ 56,982,274</u>	<u>\$ 18,182,557</u>	<u>\$ 1,457,997</u>	<u>\$ 59,161,242</u>	<u>\$ 17,794,110</u>
<u>Moody's</u>					
Aaa	\$ 2,679,225	\$ 18,182,557	\$ -	\$ 1,498,221	\$ 17,794,110
Aa	7,378,155	-	-	5,471,033	-
A	21,593,513	-	-	27,247,041	-
Baa	18,772,773	-	-	21,020,043	-
Not rated	6,558,608	-	1,457,997	3,924,904	-
	<u>\$ 56,982,274</u>	<u>\$ 18,182,557</u>	<u>\$ 1,457,997</u>	<u>\$ 59,161,242</u>	<u>\$ 17,794,110</u>

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, 2018 and 2017, 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, 2018 and 2017, the System's equity holdings accounted for 69% and 71%, respectively, of the total investment portfolio; the System's holdings in real estate were 5% at December 31, 2018 and 2017.

Rate of Return

For the year ended December 31, 2018 and 2017, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was (7.22)% and 15.72%, respectively. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED**

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, 2018 and 2017, maturities of the System's debt securities were as follows:

<u>2018</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	\$ 75,405,975	\$ -	\$ 38,858,473	\$ -	\$ 36,547,502
Corporate Bonds	56,982,274	1,084,656	32,111,729	10,773,718	13,012,171
Collateralized Mortgage Obligations	18,182,557	-	-	-	18,182,557
	<u>\$ 150,570,806</u>	<u>\$ 1,084,656</u>	<u>\$ 70,970,202</u>	<u>\$ 10,773,718</u>	<u>\$ 67,742,230</u>

  

<u>2017</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	\$ 81,536,908	\$ -	\$ 33,274,620	\$ 1,767,328	\$ 46,494,960
U.S. Agencies	1,457,997	-	-	-	1,457,997
Corporate Bonds	59,161,242	1,199,190	25,675,889	19,291,744	12,994,419
Collateralized Mortgage Obligations	17,794,110	4	-	-	17,794,106
	<u>\$ 159,950,257</u>	<u>\$ 1,199,194</u>	<u>\$ 58,950,509</u>	<u>\$ 21,059,072</u>	<u>\$ 78,741,482</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, 2018 and 2017, the portfolio had no U.S. currency futures contracts.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The System's exposure to foreign currency risk derives from its positions in foreign currency-denominated fixed-income investments. The System's investment policy permits it to invest up to 10% of total investments in foreign currency-denominated investments.

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED**

Foreign Currency Risk

The System's exposure to foreign currency risk in U.S. dollars as of December 31, 2018 and 2017, is summarized below:

Currency	2018	2017
Canadian Dollar	\$ 1,283,565	\$ 788,663
Euro	3,350,712	3,912,897
Norwegian Krone	152,258	156,827
British Pound Sterling	3,312,715	3,399,823
Mexican Peso	-	124,691
Swiss Franc	294,026	-
	\$ 8,393,276	\$ 8,382,901

**NOTE D: RESERVES**

Member contributions - Members contribute at rates stated in the City Ordinance or collective bargaining agreements for the applicable unit. Interest is credited at least annually to the reserve for member contributions. The balance represents active members' contributions and interest, less amounts transferred to funds for retirement, amounts refunded to terminated members, and transferred inactive accounts.

Employer contributions - All employer contributions are credited to the reserve for employer contributions. Interest is credited at least annually, and transfers are made to the reserve for retired benefit payments to fund the employer's share of retirement allowances, as recommended by the System's actuaries and approved by the Board of Trustees.

Retired benefit payments - The reserve represents the reserves for payment of future retirement benefits to persons already on the retirement rolls. At retirement, a member's accumulated contributions (with interest) are transferred to the reserve for retired benefit payments from the reserves for employer contributions and member contributions. Interest is credited at least annually.

The reserve balances as of December 31, 2018 and 2017, are as follows:

	2018	2017
Member contributions	\$ 28,820,252	\$ 28,210,981
Employer contributions	215,501,575	296,631,229
DROP contributions	56,687	-
Retired benefit payments	349,992,899	346,085,750
Total reserves	\$ 594,371,413	\$ 670,927,960

**NOTE E: 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. The amount paid in 2018 was \$310,860. No amounts were paid in 2017.

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE F: ADMINISTRATIVE AND INVESTMENT EXPENSES**

The following provides additional details related to administrative and investment expenses for the years ended December 31, 2018 and 2017:

	2018		2017	
	Amount	Percent of Net Position	Amount	Percent of Net Position
Investment advisor fees	\$ 2,003,554	0.337%	\$ 1,907,685	0.284%
Trust and custodial fees	199,783	0.034%	212,877	0.032%
Administrative expenses	147,100	0.025%	147,099	0.022%
Other expenses	246,932	0.042%	232,531	0.035%
	<b>\$ 2,597,369</b>		<b>\$ 2,500,192</b>	

**NOTE G: 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 H: NET PENSION ASSET**

The components of the net pension asset of the System at December 31, 2018 and 2017, were as follows:

	2018	2017
TOTAL PENSION LIABILITY		
Service cost	\$ 5,894,750	\$ 5,604,960
Interest	33,674,057	32,746,676
Changes of benefit terms	279,702	-
Differences between expected and actual experience	313,218	3,079,970
Benefit payments, including refunds of member contributions	(29,931,417)	(28,491,380)
NET CHANGE IN TOTAL PENSION LIABILITY	10,230,310	12,940,226
TOTAL PENSION LIABILITY, BEGINNING	461,005,777	448,065,551
TOTAL PENSION LIABILITY, ENDING (A)	<b>\$ 471,236,087</b>	<b>\$ 461,005,777</b>

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE H: NET PENSION ASSET - CONTINUED**

	2018	2017
PLAN FIDUCIARY NET POSITION		
Contributions - member	\$ 1,209,623	\$ 1,086,257
Net investment income (loss)	(47,440,721)	94,301,279
Benefit payments, including refunds of member contributions	(29,931,417)	(28,491,380)
Administrative expenses	(147,100)	(147,099)
Other	(246,932)	(8,848,472)
 NET CHANGE IN PLAN FIDUCIARY NET POSITION	 (76,556,547)	 57,900,585
 PLAN FIDUCIARY NET POSITION, BEGINNING	 670,927,960	 613,027,375
 PLAN FIDUCIARY NET POSITION, ENDING (B)	 \$ 594,371,413	 \$ 670,927,960
 SYSTEM'S NET PENSION (ASSET), ENDING (A)-(B)	 \$ (123,135,326)	 \$ (209,922,183)
 Plan fiduciary net position as a percentage of the total pension liability	 126.13%	 145.54%
 Covered-employee payroll	 \$ 34,999,543	 \$ 32,780,965
 System's net pension (asset) as a percentage of covered-employee payroll	 (351.82)%	 (640.38)%

Actuarial Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan understood by the employer and 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. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The total pension liability was determined by actuarial valuations as of December 31, 2017 and 2016, using the following actuarial assumptions, applied to all periods included in the measurement:

Actuarial cost method	Entry age normal
Amortization method	Level percentage of payroll, open period
Remaining amortization period	10 years
Asset valuation method	5 years smoothed market
Inflation	3.5% (which includes price inflation of 2.75%)
Projected salary increases	3.5% to 15.5% (includes inflation)
Investment rate of return	7.50%
Retirement Age	Experience-based table of rates that are specific to the type of eligibility condition. Last updated for the 2014 valuation pursuant to an experience study of the period 2009-2013.
Mortality rates	RP-2000 Mortality Combined Healthy Tables, projected 20 years with U.S. Projection Scale BB.

The actuarial assumptions used in the December 31, 2017 and 2016, valuations were based on the results of an actuarial experience study for the period January 1, 2009 through December 31, 2013.

City of Kalamazoo, Michigan  
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

December 31, 2018 and 2017

**NOTE H: NET PENSION ASSET - CONTINUED**

Discount Rate

The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that member contributions will be made at the current contribution rate and that City contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. 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.

Sensitivity of the Net Pension Liability (Asset) to Changes in the Discount Rate

The following presents the System's net pension liability (asset), calculated using the discount rate of 7.5%, as well as what the System's net pension liability (asset) would be if it were calculated using a discount rate that is 1% lower (6.5%) or 1% higher (8.5%) than the current rate:

	<u>1% Decrease (6.5%)</u>	<u>Current Discount Rate (7.5%)</u>	<u>1% Increase (8.5%)</u>
<u>2018</u>			
Total pension liability	\$ 525,987,570	\$ 471,236,087	\$ 425,502,088
Plan fiduciary net position	<u>594,371,413</u>	<u>594,371,413</u>	<u>594,371,413</u>
Net pension liability (asset)	<u>\$ (68,383,843)</u>	<u>\$ (123,135,326)</u>	<u>\$ (168,869,325)</u>
	<u>1% Decrease (6.5%)</u>	<u>Current Discount Rate (7.5%)</u>	<u>1% Increase (8.5%)</u>
<u>2017</u>			
Total pension liability	\$ 514,922,897	\$ 461,005,777	\$ 416,008,353
Plan fiduciary net position	<u>670,927,960</u>	<u>670,927,960</u>	<u>670,927,960</u>
Net pension liability (asset)	<u>\$ (156,005,063)</u>	<u>\$ (209,922,183)</u>	<u>\$ (254,919,607)</u>

**REQUIRED SUPPLEMENTARY INFORMATION**

City of Kalamazoo, Michigan  
Employees' Retirement System

SCHEDULE OF CHANGES IN THE SYSTEM'S NET PENSION ASSET AND RELATED RATIOS

Last Five Fiscal Years (ultimately ten fiscal years will be displayed)

	2018	2017	2016	2015	2014
CHANGE IN TOTAL PENSION LIABILITY					
Service cost	\$ 5,894,750	\$ 5,604,960	\$ 5,683,351	\$ 6,187,334	\$ 6,259,728
Interest	33,674,057	32,746,676	33,892,669	32,334,356	31,603,299
Changes of benefit terms	279,702	-	(23,809,450)	-	-
Difference between expected and actual experience	313,218	3,079,970	(2,513,167)	(1,574,739)	-
Changes of assumptions	-	-	-	12,509,343	-
Benefit payments, including refunds of member contributions	(29,931,417)	(28,491,380)	(28,496,870)	(28,356,700)	(27,802,129)
NET CHANGE IN TOTAL PENSION LIABILITY	10,230,310	12,940,226	(15,243,467)	21,099,594	10,060,898
TOTAL PENSION LIABILITY, BEGINNING	461,005,777	448,065,551	463,309,018	442,209,424	432,148,526
TOTAL PENSION LIABILITY, ENDING (A)	<u>\$ 471,236,087</u>	<u>\$ 461,005,777</u>	<u>\$ 448,065,551</u>	<u>\$ 463,309,018</u>	<u>\$ 442,209,424</u>
CHANGE IN PLAN FIDUCIARY NET POSITION					
Contributions - employer	\$ -	\$ -	\$ -	\$ 1,602,053	\$ 760,912
Contributions - member	1,209,623	1,086,257	1,085,940	1,084,798	1,067,029
Net investment income (loss)	(47,440,721)	94,301,279	72,939,990	(9,974,517)	41,065,447
Benefit payments, including refunds of member contributions	(29,931,417)	(28,491,380)	(28,496,870)	(28,356,700)	(27,802,131)
Administrative expenses	(147,100)	(147,099)	(153,024)	(125,770)	(122,107)
Other	(246,932)	(8,848,472)	(21,875,722)	(174,885)	(110,326)
NET CHANGE IN PLAN FIDUCIARY NET POSITION	(76,556,547)	57,900,585	23,500,314	(35,945,021)	14,858,824
PLAN FIDUCIARY NET POSITION, BEGINNING	670,927,960	613,027,375	589,527,061	625,472,082	610,613,258
PLAN FIDUCIARY NET POSITION, ENDING (B)	<u>\$ 594,371,413</u>	<u>\$ 670,927,960</u>	<u>\$ 613,027,375</u>	<u>\$ 589,527,061</u>	<u>\$ 625,472,082</u>
SYSTEM'S NET PENSION (ASSET), ENDING (A)-(B)	<u>\$ (123,135,326)</u>	<u>\$ (209,922,183)</u>	<u>\$ (164,961,824)</u>	<u>\$ (126,218,043)</u>	<u>\$ (183,262,658)</u>
Plan fiduciary net position as a percentage of the total pension liability	126.13%	145.54%	136.82%	127.24%	141.44%
Covered-employee payroll	\$ 34,999,543	\$ 32,780,965	\$ 37,291,474	\$ 37,198,788	\$ 3,631,892
System's net pension (asset) as a percentage of covered-employee payroll	(351.82)%	(640.38)%	(442.36)%	(339.31)%	(504.41)%



City of Kalamazoo, Michigan  
Employees' Retirement System

SCHEDULE OF INVESTMENT RETURNS

Last Five Fiscal Years (ultimately ten fiscal years will be displayed)

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Annual money-weighted rate of return, net of investment expense	(7.22)%	15.72%	12.64%	(1.62)%	6.82%