

**City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund**

**FINANCIAL STATEMENTS**

**December 31, 2016 and 2015**

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

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INDEPENDENT AUDITOR'S REPORT

To the Trustee of the Other Post-Employment Benefits  
Trust Fund 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 Other Post-Employment Benefits Trust Fund ( the "Plan"), as of December 31, 2016 and 2015, and the related statements of changes in plan net position for the years then ended, and the related notes to the financial statements, which collectively comprise the Plan'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 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 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 Other Post-Employment Benefits Trust Fund as of December 31, 2016 and 2015, and the respective changes in its plan net position for the years 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 Other Post-Employment Benefits Trust Fund and do not purport to, and do not present fairly the financial position of the City of Kalamazoo, Michigan, as of December 31, 2016 and 2015, 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.

### ***Change in Accounting Principles***

As discussed in Note G to the financial statements, the Plan implemented GASB Statement No. 72, *Fair Value Measurement and Application*, during the year. As a result, this statement provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. Our opinion is not modified with respect to this matter.

### ***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 funding progress and employer contributions, 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.

*Abraham & Gaffney, P.C.*

ABRAHAM & GAFFNEY, P.C.  
Certified Public Accountants

June 28, 2017

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2016

The following is a discussion and analysis of the financial performance and position of the City of Kalamazoo Other Post-Employment Benefits (OPEB) Trust Fund. It is intended to provide an overview of the OPEB Trust Fund's financial activities for the fiscal years ended December 31, 2016 and 2015. 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 highlights key financial information in a condensed format for the current year and the prior years:

	Year Ended December 31,		
	2016	2015	2014
Total assets	\$ 96,311,620	\$ 91,121,627	\$ 9,323,069
Total liabilities	932,542	730,978	612
Net position restricted for OPEB benefits	<u>\$ 95,379,078</u>	<u>\$ 90,390,649</u>	<u>\$ 9,322,457</u>
Net investment income (loss)	\$ 10,985,290	\$ (1,485,952)	\$ 520,331
Contributions	<u>4,385,073</u>	<u>92,200,393</u>	<u>1,568,554</u>
Total additions	15,370,363	90,714,441	2,088,885
Benefits paid	10,284,889	9,601,929	-
General and administrative expenses	<u>97,045</u>	<u>44,320</u>	<u>6,816</u>
Total deductions from net position	<u>10,381,934</u>	<u>9,646,249</u>	<u>6,816</u>
Net increase in net position restricted for OPEB	4,988,429	81,068,192	2,082,069
Net position restricted for OPEB benefits			
Beginning of Year	<u>90,390,649</u>	<u>9,322,457</u>	<u>7,240,388</u>
End of Year	<u>\$ 95,379,078</u>	<u>\$ 90,390,649</u>	<u>\$ 9,322,457</u>

**Overall Fund Structure and Objectives**

The OPEB Trust Fund is a single-employer defined benefit other post-employment benefit plan. The City provides medical and dental insurance benefits to eligible retirees and their spouses. Active members earn service credit that entitles them to receive benefits in the future. The City employees are expected to contribute 0.5% of their annual covered payroll. The City contributes such amounts, as necessary, based on actuarial determinations, to provide assets sufficient to pay for member benefits.

The City was required to make Annual Required Contributions (ARC) of \$6,728,006 for 2016 and \$14,118,858 for 2015. The excess of benefits over contributions is funded through investment income. The OPEB Trust Fund 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 2 years, an actuarial valuation of the OPEB Trust Fund is completed. As of the January 1, 2016, actuarial report, the valuation of assets represented 60.4 percent of accrued liabilities. As of the December 31, 2013, actuarial report, the valuation of assets represented 3.6 percent of accrued liabilities.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2016

**Asset Allocation**

It is the responsibility of the Trustee of the OPEB Trust Fund to adopt investment policies and strategies, and to select advisors, actuaries and other fiduciaries utilized by the OPEB Trust Fund.

The OPEB Trust Fund's purpose is to provide long-term benefit payments to its members through long-term investing. This is accomplished by investing OPEB assets in a "group trust" with Pension assets, to access the best long-term gains with the lowest cost. This commingled approach leverages the Pension's Retirement Investment Committee's (the RIC) 30 year history of positive investment returns for the Pension System, which has positioned the Pension System's portfolio to realize stable long-term objectives. The City hopes to achieve stability for its OPEB Trust Fund assets as well through the same level of applied wisdom, prudence, skill, and discipline.

To 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. The RIC has established the following asset allocation for the Pension System, which due to the commingling of Pension and OPEB investments in the group trust, is effectively the asset allocation for the OPEB Trust Fund as well:

<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 OPEB Trust Fund's investments are held in nine portfolios administered by five investment managers.

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

In 2014, the global economy experienced a slowdown, although systemic risk factors (such as sovereign debt, the evolving Greek crisis, global tension regarding Russian relations with its neighbors and with the G-8 nations, and the continuing destabilization of the Middle East and North Africa) failed to manifest any major damage to the global economy or broad-based equity values. Large-cap equity and equity index funds roared ahead with double-digit gains, while small cap stalled in low single digits, and international and emerging market funds faltered with modest losses. Fixed income outgained equities with nearly 7 percent gains, and real estate investments also gained over 20 percent. Equities as a group, fixed incomes, and real estate each gained ground.

In 2015, the global economy grew at 3.1 percent, continuing a trend of moderate if unspectacular expansion seen since the end of the Great Recession. Emerging markets experienced deceleration of growth from 2014, with Russia having experienced a major slowdown of negative 3.8 percent. Large-cap equity and equity index funds fell back slightly at negative 1.94 percent, while small cap and international equities shrunk by 2.38 percent and emerging market funds shrunk by 23.07 percent. Equities as a group lost 5.19 percent. Fixed income investment-grade bonds grew by a modest 3.29 percent, and real estate investments also gained 11.61 percent.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2016

In 2016, Global growth is projected to grow at 3.1 percent and 3.4 percent in 2017. The forecast reflects a more subdued outlook for advanced economies following the June 2016 U.K. vote in favor of leaving the European Union (Brexit) and weaker-than-expected growth in the United States. These developments have put further downward pressure on global interest rates, as monetary policy is now expected to remain accommodative for longer. Financial market sentiment toward emerging market economies has improved with expectations of lower interest rates in advanced economies, reduced concern about China's near-term prospects following policy support to growth, and some firming of commodity prices. <http://www.imf.org/external/pubs/ft/weo/2016/02/pdf/exesum.pdf>

In 2016, the City's Group Trust, which contains the City's Pension and OPEB investment assets, had a very strong year, with advances in every major segment of the portfolio.

Large-cap equity funds advanced strongly in 2016 at 12.94 percent, small cap and international equities gained 19.74 percent, while emerging market funds gained 19.86 percent. Equities as a group gained 16.56 percent.

Fixed income investment-grade bonds grew by a modest 2.86 percent, and real estate investments also gained 8.37 percent.

In 2015, the City implemented the second of a two-pronged approach to manage and contain retiree health care costs and the OPEB liability. First, at the close of 2014, the City Commission authorized the City Administration to issue \$90 million of fixed interest rate bonds to assist in covering a significant portion of the retiree healthcare liability, which was executed in January of 2015. Second, the City entered into Memoranda of Understanding with each of the City's collective bargaining units, which pledges the City to a fixed contribution of \$3.5 million per year, which is estimated to fully fund the City's OPEB liability over the next 30 years. In exchange, the collective bargaining units have pledged to work collaboratively the City to developing health care cost containment strategies to manage and contain retiree health care costs and the OPEB liability. As part of this strategy, the City offered an incentive to "legacy" retirees on fixed health care plans a modest incentive to participate fully in Medicare Part B. Over 80 of the 213 eligible retirees have accepted this incentive by the end of 2016, which will save the City hundreds of thousands of dollars per year.

**Contacting the OPEB Trust Fund's Financial Management**

This financial report is designed to provide the public, citizens, and other interested parties with a general overview of the OPEB Trust Fund'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  
Other Post-Employment Benefits Trust Fund

STATEMENTS OF PLAN NET POSITION

December 31, 2016 and 2015

	2016	2015
<b>ASSETS</b>		
Cash and cash equivalents	\$ 112,035	\$ 76,750
Receivables		
Interest and dividends	183,822	150,365
Investments, at fair value		
U.S. Treasuries	11,915,782	11,121,649
U.S. Agencies	202,067	668,094
Corporate bonds	9,682,042	7,582,766
Collateralized mortgage obligations	3,088,127	3,140,587
Equity mutual funds	66,103,708	63,595,423
Real estate mutual funds	5,024,037	4,785,993
Total investments	96,015,763	90,894,512
Total assets	96,311,620	91,121,627
<b>LIABILITIES</b>		
Accounts payable	932,542	730,978
<b>NET POSITION</b>		
Net position restricted for other post-employment benefits	\$ 95,379,078	\$ 90,390,649

See accompanying notes to financial statements.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

STATEMENTS OF CHANGES IN PLAN NET POSITION

Years Ended December 31, 2016 and 2015

	2016	2015
ADDITIONS TO NET POSITION		
Investment income (loss)		
Change in fair value of investments	\$ 8,701,106	\$ (3,758,317)
Interest	562,642	563,331
Dividends	1,995,627	1,994,504
Total investment income (loss)	11,259,375	(1,200,482)
Less: investment expense	(274,085)	(285,470)
Net investment income (loss)	10,985,290	(1,485,952)
Contributions		
Employer	3,500,000	91,296,479
Plan members	885,073	903,914
Total contributions	4,385,073	92,200,393
Total additions to net position	15,370,363	90,714,441
DEDUCTIONS FROM NET POSITION		
Benefits	10,284,889	9,601,929
Administrative expenses	97,045	44,320
Total deductions from net position	10,381,934	9,646,249
CHANGE IN PLAN NET POSITION	4,988,429	81,068,192
Net position - beginning of year	90,390,649	9,322,457
Net position - end of year	\$ 95,379,078	\$ 90,390,649

See accompanying notes to financial statements.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

**NOTE A: PLAN DESCRIPTION**

The City of Kalamazoo Other Post-Employment Benefits (OPEB) Trust Fund (herein after referred to as the “Plan” or “OPEB Trust Fund”) is a single-employer defined benefit other post-employment benefits plan administered by the City of Kalamazoo (the City). The City provides medical and dental insurance benefits to eligible retirees and their spouses. The City purchases Medicare supplemental insurance for retirees eligible for Medicare. In addition to the healthcare benefits described above, the Plan provides a death benefit of \$1,000 to all eligible retirees.

Membership in the Plan at January 1, 2016, (latest actuarial report) is as follows:

Retirees and beneficiaries receiving benefits	950
Active plan members	<u>414</u>
	<u><u>1,364</u></u>

Plan members are expected to contribute 0.5% of their annual covered payroll to the Plan. The City is required to contribute such additional amounts, as necessary, based on actuarial determinations, to provide assets sufficient to pay for member benefits. In 2016 and 2015, the annual required contributions for the City were \$6,728,006 and \$14,118,858, respectively.

The OPEB Trust Fund is administered by the City of Kalamazoo Other Post-Employment Benefits Trust Fund Trustee. 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 Plan’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 Other Post-Employment Benefits Trust Fund. The City of Kalamazoo is the plan sponsor of the OPEB Trust Fund. As a result, industry standards require the City to include the financial activities of the OPEB Trust Fund 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 Plan’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.

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 Trustee with the assistance of a valuation service.

Beginning in 2013, the investments of the Plan have been pooled with those of the Employees’ Retirement System. The purchases, maturities, and investment performance are allocated between the Plan and the Employees’ Retirement System based on the fair value of their respective investments. As of December 31, 2016 and 2015, the Plan’s investments represented approximately 13.2 percent and 13.4 percent of the portfolio, respectively.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

**NOTE B: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED**

Administration - Administrative costs are financed through the Plan'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 Plan does not maintain any checking or other demand/time deposit accounts. Amounts reported as cash and cash equivalents in the statement of plan net position include cash and short-term investments in money market accounts held by the Plan's investment managers. These accounts are insured by the Securities Investors Protection Corporation for up to \$500,000 each. The balance of these accounts as of December 31, 2016 and 2015, were \$112,035 and \$76,750, respectively. These amounts were fully insured during 2016 and 2015.

Investments

The Michigan Public Employees Retirement System Investment Act, Public Act 314 of 1965, as amended, authorizes the Plan to invest in stocks, government and corporate securities, mortgages, real estate, and various other investment instruments, subject to certain limitations. The Plan's Trustee 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 Plan. The City Commission is responsible for approving the recommendations of the Plan's Trustee. All investment decisions are subject to Michigan law and the investment policy established by the City Commission. As OPEB Trust Fund and Employees' Retirement System assets are commingled for investment purposes, the Plan's Trustee has adopted the policies, strategies, and approaches used by the Employees' Retirement System's Investment Committee.

The adopted asset allocation policy as of December 31, 2016 and 2015, was as follows:

<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%

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

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

Investments - continued

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

	2016	2015
U.S. Treasuries	\$ 11,915,782	\$ 11,121,649
U.S. Agencies	202,067	668,094
Corporate bonds	9,682,042	7,582,766
Collateralized mortgage obligations	3,088,127	3,140,587
Equity mutual funds	66,103,708	63,595,423
Real estate mutual funds	5,024,037	4,785,993
Total investments	\$ 96,015,763	\$ 90,894,512

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.

As of December 31, 2016, the carrying amounts and fair values for each investment are as follows:

INVESTMENT TYPE	Level 1	Level 2	Level 3	Total
U.S. Strips	\$ 202,067	\$ -	\$ -	\$ 202,067
Federal Home Loan	29,906	-	-	29,906
Fannie Mae	3,058,221	-	-	3,058,221
U.S. Treasury Notes	11,915,782	-	-	11,915,782
Corporate Bonds	-	9,682,042	-	9,682,042
Equity mutual funds	66,103,708	-	-	66,103,708
Real estate mutual funds	5,024,037	-	-	5,024,037
	\$ 86,333,721	\$ 9,682,042	\$ -0-	\$ 96,015,763

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

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

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 Plan will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Plan's investment policy does not address custodial credit risk. Although uninsured and unregistered, the Plan's investments are not exposed to custodial credit risk since the securities are held by the counterparty's trust department in the Plan'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 Plan's investment policy provides that its investments in bonds must be rated in the top four (4) major investment grades as determined by two (2) nationally recognized statistical rating organizations. As of December 31, 2016 and 2015, the Plan's investments in fixed income securities were rated by Standard & Poor's and Moody's as follows:

Standard & Poor's	2016			2015		
	U.S. Agencies	Corporate Bonds	CMO	U.S. Agencies	Corporate Bonds	CMO
AAA	\$ -	\$ 1,009,439	\$ -	\$ -	\$ 147,239	\$ 551,183
AA	-	1,143,061	3,088,127	-	1,112,185	13,025
A	-	3,710,494	-	-	2,908,196	-
BBB	-	3,713,743	-	-	3,371,922	-
Not rated	202,067	105,305	-	668,094	43,224	2,576,379
	<u>\$ 202,067</u>	<u>\$ 9,682,042</u>	<u>\$ 3,088,127</u>	<u>\$ 668,094</u>	<u>\$ 7,582,766</u>	<u>\$ 3,140,587</u>
<u>Moody's</u>						
Aaa	\$ -	\$ 752,048	\$ 3,088,127	\$ -	\$ 219,613	\$ 192,503
Aa	-	948,019	-	-	677,346	-
A	-	3,801,960	-	-	3,379,633	-
Baa	-	3,683,641	-	-	3,262,950	-
Not rated	202,067	496,374	-	688,094	43,224	2,948,084
	<u>\$ 202,067</u>	<u>\$ 9,682,042</u>	<u>\$ 3,088,127</u>	<u>\$ 688,094</u>	<u>\$ 7,582,766</u>	<u>\$ 3,140,587</u>

Concentration of Credit Risk

The Plan'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, 2016 and 2015, the Plan's investments were within that range.

The Plan'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, 2016 and 2015, the Plan's equity holdings accounted for 69% and 70%, respectively, of the total investment portfolio; the Plan's holdings in real estate were 5% and 5% at December 31, 2016 and 2015.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

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

Rate of Return

For the years ended December 31, 2016 and 2015, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 12.64 percent and (1.62) percent, respectively. The money weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

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 Plan's investment policy does not address interest rate risk. As of December 31, 2016 and 2015, maturities of the Plan's debt securities were as follows:

	Fair Value	Investment Maturities (fair value by years)			
		Less than 1	1-5	6-10	More than 10
<u>2016</u>					
U.S. Treasuries	\$ 11,915,782	\$ -	\$ 6,260,662	\$ 874,532	\$ 4,780,588
U.S. Agencies	202,067	-	-	-	202,067
Corporate Bonds	9,682,042	287,571	3,505,323	3,735,118	2,154,030
Collateralized Mortgage Obligations	3,088,127	-	898	-	3,087,229
	<u>\$ 24,888,018</u>	<u>\$ 287,571</u>	<u>\$ 9,766,883</u>	<u>\$ 4,609,650</u>	<u>\$ 10,223,914</u>
<u>2015</u>					
U.S. Treasuries	\$ 11,121,649	\$ 572,508	\$ 5,234,785	\$ -	\$ 5,314,356
U.S. Agencies	668,094	-	599,937	-	68,157
Corporate Bonds	7,582,766	142,988	1,440,219	3,307,864	2,691,695
Collateralized Mortgage Obligations	3,140,587	122	396,921	13,025	2,730,519
	<u>\$ 22,513,096</u>	<u>\$ 715,618</u>	<u>\$ 7,671,862</u>	<u>\$ 3,320,889</u>	<u>\$ 10,804,727</u>

Derivatives

The Plan'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 Plan's Trustee, in conjunction with the Employees' Retirement System's Investment Committee, monitors these reports to evaluate the Plan'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, 2016 and 2015, 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 Plan's exposure to foreign currency risk derives from its positions in foreign currency-denominated fixed-income investments. The Plan's investment policy permits it to invest up to 10 percent of total investments in foreign currency-denominated investments.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

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

Foreign Currency Risk - continued

The Plan's exposure to foreign currency risk in U.S. dollars as of December 31, 2016, is summarized below:

Currency	Fixed Income
Canadian Dollar	\$ 119,589
Euro	886,257
Norwegian Krone	24,741
British Pound Sterling	421,498
Mexican Peso	45,086
	\$ 1,497,171

**NOTE D: ADMINISTRATIVE AND INVESTMENT EXPENSES**

The following provides additional details related to administrative and investment expenses for the years ended December 31, 2016 and 2015:

	2016		2015	
	Amount	Percent of Net Position	Amount	Percent of Net Position
Investment advisor fees	\$ 274,085	0.287%	\$ 285,470	0.316%
Administrative expenses	97,045	0.102%	44,320	0.049%
	\$ 371,130		\$ 329,790	

**NOTE E: RISK MANAGEMENT**

The Plan is exposed to various risks of loss related to torts, errors and omissions. The Plan 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 Plan that would require a liability to be recorded in the financial statements.

**NOTE F: FUNDED STATUS AND FUNDING PROGRESS**

The Plan's funding policy provides for periodic contributions by the City at actuarially determined rates expressed as a percentage of annual covered payroll. The City is required to contribute at a rate of 17.4% of annual covered payroll. The annual required contribution (ARC) represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty (30) years.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

**NOTE F: FUNDED STATUS AND FUNDING PROGRESS - CONTINUED**

The funded status of the Plan as of January 1, 2016, the date of the most recent actuarial valuation, was as follows:

Actuarial value of assets	\$ 94,643,208
Actuarial accrued liability (AAL)	<u>156,809,472</u>
Underfunded AAL (UAAL)	<u>\$ (62,166,264)</u>
Funded ratio	<u>60.4%</u>
Covered payroll	<u>\$ 38,760,334</u>
UAAL as % of covered payroll	<u>160.4%</u>

Actuarial Methods and Assumptions

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented in the required supplementary information, presents multi-year trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities or benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as 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 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.

For the years ended December 31, 2016 and 2015, the City's annual OPEB costs were \$6,853,533 and \$12,953,055, respectively. The estimated annual required contribution was determined as part of an actuarial valuation at January 1, 2016, using the individual entry age method. Actual required contributions are based on actual reported monthly payroll. Significant actuarial assumptions used include (a) a 7.5 percent investment rate of return (b) projected salary increases of 3.5% per year compounded annually, attributable to inflation (c) additional salary increases ranging from 0.0% to 12.0% per year depending on age, seniority and merit, (d) the healthcare cost trend rate of 3.5% to 9.0%, and (e) assumption benefits will not increase after retirement. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a five (5) year period. The unfunded actuarial liability is being amortized as a level percentage of payroll over a period of thirty years on a closed basis.

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

**NOTE F: FUNDED STATUS AND FUNDING PROGRESS - CONTINUED**

The City's computed contribution and actual funding are summarized as follows:

	Year Ended December 31, 2016	2015
Annual required contribution (ARC)	\$ 6,728,006	\$ 14,118,858
Interest on net OPEB obligation	(973,455)	2,615,361
Adjustment to annual required contribution	<u>1,098,982</u>	<u>(3,781,164)</u>
Annual OPEB cost	6,853,533	12,953,055
Contributions made	<u>3,520,000</u>	<u>91,316,479</u>
Increase (decrease) in net OPEB obligation	3,333,533	(78,363,424)
Net OPEB obligation (benefit) - beginning of year	<u>(12,979,404)</u>	<u>65,384,020</u>
Net OPEB (benefit) - end of year	<u>\$ (9,645,871)</u>	<u>\$ (12,979,404)</u>

The annual OPEB cost, the percentage contributed to the plan, and the net OPEB obligation for the years ended December 31, were as follows:

	<u>2014</u>	<u>2015</u>	<u>2016</u>
Annual required contribution (ARC)	\$ 14,115,049	\$ 14,118,858	\$ 6,728,006
Percentage contributed	72.6%	646.8%	51.4%
Net OPEB obligation (benefit)	\$ 65,384,020	\$(12,979,404)	\$ (9,645,871)

**NOTE G: CHANGE IN ACCOUNTING PRINCIPLES**

GASB Statement No. 72, *Fair Value Measurement and Application*, was implemented during the year. This statement addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is 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. This statement provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

**NOTE H: UPCOMING ACCOUNTING PRONOUNCEMENTS**

In June 2015, the GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The statement will establish accounting and financial reporting requirements related to other postemployment benefit plans and specify the required approach to measuring the OPEB liability of employers. The statement also enhances accountability and transparency through revised note disclosures and required supplementary information (RSI). The Plan is currently evaluating the impact this standard will have on the financial statements when adopted for the 2017 fiscal year.

**REQUIRED SUPPLEMENTARY INFORMATION**

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Underfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
1/1/2016	\$ 94,643,208	\$ 156,809,472	\$ 62,166,264	60.4%	\$ 38,760,334	160.4%
12/31/2013	6,931,353	194,792,158	187,860,805	3.6%	37,509,463	500.8%
12/31/2011	-	190,631,174	190,631,174	0.0%	44,227,533	431.0%
12/31/2009	-	263,181,931	263,181,931	0.0%	44,060,796	597.3%
12/31/2007	-	206,854,739	206,854,739	0.0%	45,214,897	457.5%

City of Kalamazoo, Michigan  
Other Post-Employment Benefits Trust Fund

SCHEDULE OF EMPLOYER CONTRIBUTIONS

<u>Year Ended December 31,</u>	<u>Annual Required Contribution</u>	<u>Percentage Contribution</u>
2016	\$ 6,728,006	52%
2015	14,118,858	647%
2014	14,115,049	73%
2013	14,648,903	100%
2012	14,789,698	46%
2011	23,118,784	29%
2010	23,118,784	31%
2009	19,533,175	33%
2008	18,129,246	34%