

**EMPLOYEES, RETIREES AND BENEFICIARIES
OF THE CITY OF KALAMAZOO, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

The Summary Annual Report of the City of Kalamazoo Employees' Retirement System is presented for your information.

The report summarizes the financial condition of the Retirement System as of December 31, 2011. The information presented in this report is based on the financial statements as audited by Abraham and Gaffney and the 2011 Actuarial Valuation prepared by Gabriel, Roeder, Smith & Company.

The City Charter requires that the City maintain an employees' retirement system. The City of Kalamazoo Employees' Retirement System was established as a "defined benefit" plan on July 1, 1942, by authority of Ordinance 188, as amended. As a "defined benefit" plan, the City must provide the benefits as defined in the plan, regardless of the cost. Therefore, the entire risk associated with providing the promised benefits rests with the City.

At year-end 1981, when the Investment Committee was created and applicable policies were implemented, the actuarial value of the assets was approximately \$26 million, the accrued liabilities were \$45.9 million and the funded ratio (actuarial assets divided by accrued liabilities) was 56%. The market value of the assets at 12/31/2011 was \$483 million, the actuarial value was \$509 million, the accrued liabilities were \$381 million, and the funded ratio was 133.9% on a valuation basis.

Our investment managers continue to do hard work for the participants in a difficult market and economy. The year 2011 was not rewarding with a -2.2% return, adjusted for inflation and net of fees. The Investment Committee has remained dedicated to their strategy and feels confident about the long-term outcome. There have been no changes in fund managers this year.

Merion Capital LLC continues to provide investment analysis, reporting services and additional investment information as needs arise. The Committee has been very pleased with this relationship.

The Retirement System continues to be managed very cost effectively. The total expenses for the plan were \$2,008,537, or 0.416% for 2011. The Actuary assumes 0.50% for expenses. The average total cost for both private and public retirement systems is between 0.90% and 1.20%. Our low expense ratio is a substantial cost savings to the System.

Once again, this year's annual report has been combined with a pension guide for employees. This guide will help employees become familiar with the provisions of the plan.

It is a pleasure to report that the Employees' Retirement System is in sound financial condition and that the fiduciaries remain committed to meet the obligations of the defined benefit plan in a prudent manner.

Respectfully submitted,

Thomas C. Skrobola
Director of Management Services/CFO, Secretary to the Pension Board, and Pension Administrator

STRUCTURE

The City Commission established a five member Board of Trustees of the Employee Retirement System to administer the system in accordance with the provisions set forth in the Code of Ordinances of the City of Kalamazoo. The Board of Trustees consists of a City Commissioner selected by the City Commission, the City Manager, a citizen who is appointed by the City Commission, a public safety member elected by the public safety members and a general member elected by the general members. The current board members and terms are as follows:

<u>BOARD MEMBER</u>	<u>TERM EXPIRES</u>
Dr. Randall Eberts (Citizen at Large).....	3/31/2015
James Mallery (Public Safety Member)	3/31/2014
Vacant (General Member)	
Kenneth Collard (City Manager) Chairman Pro Tem	
Barbara Miller (City Commissioner)	

Thomas Skrobola, Management Services Director and Chief Financial Officer, serves as Secretary to the Pension Board.

In addition to the Board of Trustees, the City Commission created the Investment Committee on October 19, 1981. The Investment Committee is charged with the management of the system's assets and has full authority to invest and reinvest such assets subject to the provisions of applicable state and local laws, ordinances and the investment policy. The Investment Committee is composed of as many as seven (7) members, all have an extensive financial background and none are participants in the system. The members are appointed by the Mayor with the consent of the City Commission and serve three (3) year terms. The current members of the Investment Committee are as follows:

<u>BOARD MEMBER</u>	<u>TERM EXPIRES</u>
Robert Salisbury, Chair	3/31/2014
Dr. Randall Eberts, Vice Chair	3/31/2014
Daniel DeMent.....	3/31/2014
LaJune Montgomery-Tabron	3/31/2014
Tom Ponto	3/31/2013
Janice Van Der Kley	3/31/2013
Dean Bergy.....	3/31/2013

City Commission Liaison: David Anderson

Thomas Skrobola, Management Services/Finance, serves as Secretary to the Investment Committee.

INVESTMENT POLICY

The financial objective of the Retirement System is to accumulate a pool of assets that will be sufficient to pay the benefits promised by the system, at the lowest possible cost, and to do so solely in the interest of the participants and beneficiaries.

Within this objective, the system's assets are to be invested to achieve the maximum long term (3-4 market cycles) cumulative annual rate of return possible in relation to risk under the laws and regulations under which the assets can be invested. The Investment Committee has established an investment policy, which provides that the maximum amount permitted under the laws and regulations, will be targeted for investment in common stocks with the balance invested in bonds, short-term securities and real estate.

MONEY MANAGERS AND PHILOSOPHIES

To mitigate volatility, the assets of the system are invested in various asset classes (common stocks, bonds, etc.) and in different investment styles within the classes. Managers are hired for their management style and strategy within these classes of assets. If a manager deviates from the style and strategy for which that firm was hired and the new style and strategy is in conflict with the investment policies, the manager is terminated.

The Employee Retirement System has four (4) investment managers who are responsible for the investment of the system's assets in accordance with the Investment Committee's policies. Two of the money managers are common stock managers, one is a bond manager and one is a real estate manager.

Barclays Global Investors - (BGI)

BGI, San Francisco California, has over \$1.5 trillion in assets under management. The System's assets are invested in BGI's equity index fund, which replicates the S&P 500 Stock Index.

Dimensional Fund Advisors - (DFA)

Dimensional Fund Advisors, Santa Monica California, has over \$100 billion in assets under management. DFA manages the System's large cap value fund, the small cap value fund, the micro cap fund and the international small company fund, in addition to managing part of the real estate investments.

Jennison Associates LLC

Jennison Associates, Boston MA, manages over \$60 billion in assets and serves as the System's long term and intermediate fixed income manager.

RREEF America Reit II, Inc.

RREEF America Reit II, Inc., San Francisco California, has over \$32 billion in assets under management and serves as one of the System's two real estate investment vehicles.

The Vanguard Group, Inc.

The Vanguard Group of Malvern, Pennsylvania, has over \$1.7 trillion in assets under management. The System's assets are invested in Vanguard's Real Estate Investment Trust (REIT), which is one of the System's two real estate investment vehicles.

State Street Bank

The balance of the System's assets is held in cash equivalents in order to meet monthly benefit payments and administrative expenses. State Street Bank & Trust, Boston MA has over \$12 trillion in assets under administration or in custody and serves as the System's Custodian and Trustee. State Street Bank safeguards the System's assets and serves as the control and monitoring point for the performance and procedures of our investment managers.

**CITY OF KALAMAZOO
EMPLOYEES RETIREMENT SYSTEM
PORTFOLIO PROFILE
DECEMBER 31, 2011**

	<u>MARKET VALUE</u>	<u>PERCENT OF TOTAL</u>
BGI S&P 500 EQUITY INDEX	\$144,433,844	29.91%
DFA MICRO CAP	\$24,312,045	5.03%
DFA SMALL CAP VALUE	\$48,588,949	10.06%
DFA LARGE CAP VALUE	\$24,153,089	5.00%
DFA INT' SMALL CAP VALUE	\$47,257,712	9.79%
DFA EMERGING MARKETS	\$46,004,483	9.53%
TOTAL EQUITIES	\$334,750,121	69.32%
JENNISON INTERMEDIATE BOND	\$123,209,773	25.51%
TOTAL FIXED INCOME	\$123,209,773	25.51%
VANGUARD REIT INDEX	\$11,563,858	2.40%
RREEF REAL ESTATE	\$13,114,137	2.72%
SHORT-TERM INVESTMENTS	\$243,285	0.06%
TOTAL FUND	<u>\$482,881,173</u>	<u>100.0%</u>

Michigan Public Act 485 limits the percentage of system assets invested in equity securities to 70% of the total portfolio.

SYSTEM EXPENSES

The Investment Committee is committed to the cost effective management of the system. All fees and expenses are reviewed and approved in open Committee meetings.

It is customary to measure expenses as a percent (%) of assets under management in terms of Basis Points (BP). One hundred basis points is equal to 1%. One basis point (1 BP) is equal to one-hundredth of a percent (0.01%) of assets under management.

The 2011 expenses were as follows:

	<u>EXPENSE</u>	<u>% OF MARKET ASSETS</u>
Investment management fees	\$1,548,904	32.1 BP or .321%
Trust and custodial fees	\$208,293	4.3 BP or .043%
Administrative fees paid to the City	\$115,097	2.4 BP or .024%
Other: (Audit, Actuary, Due Diligence, etc.)	<u>\$136,243</u>	<u>2.8 BP or .028%</u>
TOTAL	<u>\$2,008,537</u>	<u>41.6 BP or .416%</u>

INVESTMENT PERFORMANCE

The investment objective is to achieve a "real" rate of return (nominal rate less inflation) of 5% over time. This objective has been achieved since the inception of the current organization in 1982.

Annualized Rates of Return For Periods Ending December 31

	<u>2011</u> <u>1 year</u>	<u>2007-2011</u> <u>5 years</u>	<u>Since</u> <u>1982</u>
Nominal Rate of Return	-2.2%	1.8%	11.2%
Inflation	3.0%	2.1%	3.0%
Real Rate of Return	-5.2%	-0.3%	8.2%

ACTUARIAL FUNDING OF BENEFITS

At December 31, 2011, the System's membership consisted of 1,555 employees, retirees, beneficiaries, and individuals entitled to deferred benefits. During 2011, \$18.14 million was distributed to retirees and beneficiaries in the form of benefit payments. Not all participants of the system have yet earned the right to receive benefits. Of the 1,555 members, there are 766 participants or beneficiaries receiving pensions, 48 entitled to deferred benefits and 775 active members currently contributing to the System.

Employer contributions, if applicable, are made in accordance with the funding rates recommended by Gabriel, Roeder, Smith & Company, in the annual Actuarial Valuation Report. The 2011 valuation report is again recommending \$0 contributions. Employee contributions are made in accordance with union contracts or, in the case of non-bargained employees, in accordance with provisions within the code of ordinances.

The market value of assets is not used for funding level calculation purposes. Instead, each year's investment gains or losses are spread equally over the following five (5) years by the actuary. This reduces annual fluctuations in asset value and contribution rates caused by changes in market conditions.

The market value of assets available for plan benefits at the end of 2011 was \$482,881,173 and the actuarial value of assets was \$509,931,421. The difference between the market value and the actuarial value is the unrecognized gain or loss that will be recognized over the next five (5) years by the actuary. This amount for 2011 is a loss of \$27,050,248. There is \$1.339 of actuarial assets for each \$1.00 of liabilities and \$1.268 of market value for each \$1.00 of liabilities.

ACTUARIAL FUNDING (\$ 000)

YEAR ENDED	ACTUARIAL ASSETS	ACTUARIAL LIABILITIES	ASSETS AS % OF LIABILITIES
1970	\$6,782	\$10,921	62.1%
1980	\$28,151	\$42,848	65.7%
1990	\$99,014	\$100,981	98.1%
2000	\$331,443	\$208,070	159.3%
2010	\$518,339	\$367,423	141.1%
2011	\$509,931	\$380,802	133.9%

At year-end 2011 the unrecognized loss was \$27,050,248. By policy, any annual gain or loss will be recognized over five years however; the actuarial assets may not be less than 80% of the market value of assets.

SUMMARY OF PLAN ASSETS
MARKET VALUE BASIS
December 31, 2011

NET ASSETS AT BEGINNING OF PERIOD	\$511,217,114
 ADDITIONS:	
Employer Contributions	\$0
Employee Contributions	\$1,519,670
Investment Gain(Loss)	(\$9,664,841)
 TOTAL ADDITIONS	 (\$8,145,171)
 DEDUCTIONS:	
Benefit Payments	\$18,140,577
Participant Withdrawals	\$249,949
Administrative Expenses	\$251,340
Investment Manager Fees	\$1,548,904
 TOTAL DEDUCTIONS	 \$20,190,770
 NET ASSETS AT END OF PERIOD	 <u>\$482,881,173</u>

During 2011 the system experienced a net decrease in the value of its assets of \$28,335,941. This decrease includes unrealized appreciation of the value of the system assets; that is, the difference between the market value of the system's assets at the end of the year and the market value of the system's assets at the beginning of the year, and the cost of assets acquired during the year.

HOW TO OBTAIN ADDITIONAL INFORMATION

You have the right to examine the text of the Retirement Ordinance, Actuarial Valuation and the Audited Financial Report. These are available during regular business hours in the Management Services Division of City Hall or at the City of Kalamazoo website www.kalamazoocity.org.

If you have questions or need information regarding the Retirement System, please contact:

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skrobolat@kalamazoocity.org