

City of Pontiac Police and Fire Retirement System

Management's Discussion and Analysis

Using this Annual Report

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

Condensed Financial Information

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

	Fiscal Year Ended December 31	
	2005	2004
Total assets	\$ 269,657,894	\$ 266,169,012
Total liabilities:		
Amounts due broker under securities lending agreement	19,209,862	19,362,887
Other liabilities	335,558	214,038
Total liabilities	19,545,420	19,576,925
Assets held in trust for pension benefits	<u>\$ 250,112,474</u>	<u>\$ 246,592,087</u>
Net investment income	\$ 14,183,883	\$ 16,550,195
Net securities lending income	18,047	24,579
Contributions:		
Employee - Reinstated members	384,353	392,791
Employer	2,246,000	2,141,247
Benefits paid to members and retirees:		
Retiree pension and annuity benefits	12,528,135	12,114,123
Member refunds and withdrawals	355,021	47,626
Total benefits paid	12,883,156	12,161,749
Benefits paid in excess of contributions	10,252,803	9,627,711
Ratio of benefits paid to contributions	489.8%	479.9%
General and administrative expenses	428,740	136,332
Net increase in net assets held in trust	<u>\$ 3,520,387</u>	<u>\$ 6,810,731</u>

City of Pontiac Police and Fire Retirement System

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

The City of Pontiac Police and Fire Retirement System (the "Retirement System") exists to pay benefits to its members and retirees. 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. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

Asset Allocation

The Retirement System has established asset allocation policies, which are expected to deliver more than enough investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Retirement System. The following is a summary of the asset allocation as of December 31, 2005:

Domestic equities	41%
International equities	14%
Domestic fixed income	37%
Real estate	8%

Investment Results

While returns were down from the prior year, both the domestic equity and domestic bond markets posted positive returns during the past year. In 2005, the U.S. equities were again helped by strong profits, as well as by the expectation that the federal reserve would raise rates only one or two more times during the first quarter of 2006 and may even begin to lower rates by the end of 2006. U.S. bonds were helped by benign inflation reports and continued foreign investment in domestic bonds. The domestic equity market, as measured by the S&P 500 Index, returned 4.9 percent for the year. The fixed income market, as measured by the Lehman Aggregate Index, returned 2.0 percent for the year. The international equity market, as measured by the MCSI EAFE (non-U.S.) Index returned 13.5 percent for the year. The total fund returned 6.05 percent for the year.

The Retirement System's total fund return must always be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the Retirement System to pay the benefits promised to members and retirees are very long-term obligations. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the Retirement System over many years, not just one or two years.