

City of Ann Arbor
Employees' Retirement System

For the Year Ended
June 30, 2023

Financial
Statements

Rehmann

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CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

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INDEPENDENT AUDITORS' REPORT

October 18, 2023

To the Board of Trustees
City of Ann Arbor Employees' Retirement System
Ann Arbor, Michigan

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the **City of Ann Arbor Employees' Retirement System** (the "System"), a *fiduciary component unit of the City of Ann Arbor, Michigan*, as of and for the year ended June 30, 2023, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the System, as of June 30, 2023, and the respective change in fiduciary net position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Independent Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the System and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.



In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the System's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Independent Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- exercise professional judgment and maintain professional skepticism throughout the audit.
- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- obtain an understanding of internal control relevant to the audit 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 System's internal control. Accordingly, no such opinion is expressed.
- evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the System's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis, and the schedules, as listed in the table of contents, be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2023, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Rehmann Johnson LLC". The signature is written in a cursive, flowing style.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

The City of Ann Arbor Employees' Retirement System (the "System") is a single-employer defined benefit retirement and defined contribution plan established and administered by the City of Ann Arbor, Michigan (the "City") which provides pension, disability and death benefits to general, police, and firefighter employees and their beneficiaries. The System is administered by the City; accordingly, it is included as a fiduciary component unit in the City's financial statements. The System presents this discussion and analysis of its financial performance as an overview of its financial activities for the fiscal year ended June 30, 2023. We encourage readers to consider the information presented here in conjunction with the accompanying financial statements.

Using this Annual Report

The discussion and analysis is intended to serve as an introduction to the System's financial statements. The System's financial statements are comprised of four components: 1) statements of fiduciary net position, 2) statement of changes in fiduciary net position, 3) notes to the financial statements, and 4) required supplementary information.

- The *statement of fiduciary net position* presents information on all of the System's assets and liabilities, with the net of these reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the System is improving or deteriorating.
- The *statement of changes in fiduciary net position* presents information showing how the System's net position changed during the most recent fiscal year.
- The *notes to the financial statements* provide additional information that is essential to a full understanding of the data provided in the financial statements.
- The *required supplementary information (RSI)* provides additional information that is essential to a full understanding of the data provided in the financial statements. More specifically, the RSI provides ten years of data for the schedule of changes in net pension liability (asset) and related ratios, schedule of contributions, the schedule of investment returns, and related notes.

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

Financial Analysis

The net position of the System is summarized for the purpose of determining the overall fiscal position. As shown below, the System's assets exceeded liabilities by \$611,614,381 at the end of the fiscal year.

A comparative analysis of the data is presented below:

	Net Position	
	2023	2022
Assets		
Equity in the City's pooled cash and investments	\$ 1,743,014	\$ 5,594,514
Investments, at fair value	612,594,461	573,117,763
Other assets	900,464	490,053
Capital assets being depreciated, net	300,254	312,106
Total assets	<u>615,538,193</u>	<u>579,514,436</u>
Deferred outflows of resources	<u>-</u>	<u>109,015</u>
Liabilities		
Accounts payable	3,923,812	3,737,802
Other long-term liabilities	-	501,447
Total liabilities	<u>3,923,812</u>	<u>4,239,249</u>
Deferred inflows of resources	<u>-</u>	<u>103,207</u>
Net position - restricted for pension benefits	<u>\$ 611,614,381</u>	<u>\$ 575,280,995</u>

During fiscal year 2023, the City changed its method of allocation for the Net Pension Liability, Net OPEB Liability, and the related deferred inflows and outflows of resources. As a result, the City no longer allocates a portion of either liability or the related deferrals to the pension trust fund.

	Changes in Net Position	
	2023	2022
Total additions (net of investment loss in 2022)	\$ 80,988,894	\$ (11,302,627)
Total deductions	44,655,508	42,884,949
Change in net position	36,333,386	(54,187,576)
Net position, beginning of year	575,280,995	629,468,571
Net position, end of year	<u>\$ 611,614,381</u>	<u>\$ 575,280,995</u>

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Management's Discussion and Analysis

When comparing the current fiscal year to the previous, net position increased by \$36,333,386. The majority of the increase is due to investment income generated by strong investment performance of the System's investment portfolio.

Additional information on the System's investments can be found in the notes to the financial statements.

Contributions

The System's contributions consist of both employer and employee contributions. For the year ended June 30, 2023, contributions to the System decreased by \$1,184,850, primarily due to a reduction in the System's Actuarially Determined Contribution (ADC) based on the System's actuarial funding valuation.

	Contributions	
	2023	2022
Employer	\$ 15,573,621	\$ 16,950,388
Employee	3,849,807	3,657,890
Total contributions	<u>\$ 19,423,428</u>	<u>\$ 20,608,278</u>

Additional information on the System's contributions can be found in the notes to the financial statements.

Economic Factors and Investment Returns

It should be noted that this financial discussion and analysis relates to the financial status of the System. The activity of the City's health care plan is presented in separately issued City of Ann Arbor Retiree Health Care Benefits Plan and Trust financial statements.

It is the System's purpose to provide long-term benefit payments to its members, and it is through long-term investment strategies that these benefits will be primarily funded. It is recognized that in the short term there will be market fluctuations that may result in negative returns in any given period. Through its investment policy asset allocation, the Board of Trustees positions the portfolio to meet its long-term obligations. In addition, to further maximize investment returns, the Board of Trustees carefully monitors the performance of each of its investment managers and takes necessary corrective action to ensure acceptable investment results. Management believes that the System will continue to provide the benefits to participants as it is contractually obligated.

Contacting the City of Ann Arbor Employees' Retirement System

This financial report is designed to provide a general overview of the System's finances and to show accountability for the money it receives and expends. Questions concerning any of the information should be addressed to the City of Ann Arbor Employees' Retirement System at 532 S. Maple Road, Ann Arbor, MI 48103.

FINANCIAL STATEMENTS

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Statement of Fiduciary Net Position

June 30, 2023

Assets

Investments, at fair value:

Equities	\$ 392,269,065
Fixed income	84,793,003
Other	<u>135,532,393</u>

Total investments 612,594,461

Equity in City of Ann Arbor pooled cash and investments	1,743,014
Accrued interest and dividends	586,249
Due from the City of Ann Arbor	314,215
Capital assets being depreciated, net	<u>300,254</u>

Total assets 615,538,193

Liabilities

Accounts payable and accrued liabilities 3,923,812

Net position restricted for pension \$ 611,614,381

The accompanying notes are an integral part of these financial statements.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Statement of Changes in Fiduciary Net Position

For the Year Ended June 30, 2023

Additions

Investment income:

From investing activities:

Net appreciation in fair value of investments	\$ 53,036,348
Interest and dividends	9,098,808
Total investment income	<u>62,135,156</u>
Investment management fees	<u>(601,738)</u>
Net investment income from investing activities	<u>61,533,418</u>

From securities lending activities:

Gross earnings	51,660
Borrower rebates received (paid)	(50,146)
Securities lending fees	30,534
Net investment income from securities lending activities	<u>32,048</u>

Total net investment income	<u>61,565,466</u>
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Contributions:

Employer	15,573,621
Plan members	<u>3,849,807</u>

Total contributions	<u>19,423,428</u>
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Total additions	<u>80,988,894</u>
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Deductions

Benefits	43,842,867
Refunds	444,680
Administrative expenses	<u>367,961</u>

Total deductions	<u>44,655,508</u>
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Change in net position	<u>36,333,386</u>
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Net position, beginning of year	<u>575,280,995</u>
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Net position, end of year	<u><u>\$ 611,614,381</u></u>
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The accompanying notes are an integral part of these financial statements.

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NOTES TO FINANCIAL STATEMENTS

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Notes To Financial Statements

1. PLAN DESCRIPTION

Plan administration. The City of Ann Arbor Employees' Retirement System (the "System") is a single-employer defined benefit retirement and defined contribution plan retirement plan established and administered by the City of Ann Arbor, Michigan (the "City") which provides pension, disability and death benefits to general, police, and firefighter employees and their beneficiaries. Cost of living adjustments may be provided to members and beneficiaries. The City Charter assigns the authority to establish and amend benefit provisions to the City Council. The financial statements of the System are included as a pension trust fund in the City's financial statements.

Management of the System is vested in the City of Ann Arbor Employees' Retirement System Board of Trustees, which consists of nine members, three are elected (representing fire, police, and general City employees), five are appointed by the City Council of the City of Ann Arbor, and one is the Chief Financial Officer of the City of Ann Arbor, who serves as ex-officio member.

Plan membership. Membership of the System consisted of the following at June 30, 2022, the date of the latest actuarial valuation:

Retirees and beneficiaries currently receiving benefits	1,156
Terminated employees entitled to but not yet receiving benefits	102
Active members	<u>711</u>
Total membership	<u><u>1,969</u></u>

Benefits provided. The System provides retirement, disability, and death benefits. Retirement benefits for general plan members are calculated as 2.5 percent of the member's final three-year average salary or five-year average salary depending on hire date, times the member's years of service. Benefits for public safety plan members (police and fire) are calculated as 2.75 percent of the member's final three-year average salary or five-year average salary depending on hire date, times the member's years of service. Effective January 1, 2017, the System was amended and restated to add to the existing defined benefit plan (to be called the "Traditional Retirement Plan"), a defined contribution money purchase pension plan (the "Dual Retirement Plan") which will only apply to non-union, AFSCME, and Teamsters Civilian Supervisor employees first hired or rehired on or after January 1, 2017. Employees who are members of the Dual Retirement Plan will also participate in and accrue benefits under the Traditional Retirement Plan but at a rate of accruals that is 50% of the rate of accruals for members of the Traditional Retirement Plan who were hired or rehired prior to January 1, 2017. Certain collective bargaining units may agree that newly hired or rehired members of that union will be covered by the Dual Retirement Plan on dates after January 1, 2017. The Traditional Retirement Plan and the Dual Retirement Plan are together called the City of Ann Arbor Employees' Retirement System (CAAERS).

General plan members with 20 years of service are eligible to retire at age 50 with an early retirement reduction of .333 percent for each month that retirement precedes the normal retirement date. Public safety plan members with 20 years of service are eligible to retire at age 50 with an early retirement reduction of .333 percent for each month that retirement precedes the normal retirement date.

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Notes To Financial Statements

General plan members may retire with an unreduced benefit at age 50 after 25 years of service, or age 60 with five or 10 years of service depending on hire date. Public safety plan members may retire at any age after 25 years of service or at age 55 with five or 10 years of service depending on hire date. Deferred members may retire at age 60 with five or 10 years of service depending on date of hire. All plan members are eligible for non-duty disability benefits after five or 10 years depending on date of hire, and for duty-related disability benefits upon hire. Disability retirement benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction.

A plan member who leaves City service may withdraw his or her contributions plus any accumulated interest. A withdrawal may reduce or even eliminate any future benefit payable under a deferred vested retirement.

The System offers a minimum benefit of \$9,800 adjusted by a cost of living factor each year and prorated for less than 20 years of service. For the FYE beginning July 1, 2022, the adjusted minimum benefit amount was \$16,844 (prorated for less than 20 years of service). In addition, annually, the Board of Trustees, in consultation with its actuary and upon receipt of the actuarial report for each fiscal year, determines whether to grant a permanent pension benefit adjustment or pay a one-time supplemental benefit based upon the amount, if any, of funds in the pension adjustment account which may be distributed to eligible retirees and beneficiaries. The aggregate cost of such benefit adjustment or supplemental benefit distribution is funded by a transfer from the pension adjustment account to the pension reserve. No pension benefit adjustment or supplemental benefit can be paid unless the amount available in the pension adjustment account is equal to or greater than 1% of the total pension payroll. The term "total pension payroll" means the total amount of pension benefits paid to retirees and beneficiaries in the prior fiscal year as reflected in the annual actuarial report.

Contributions - Traditional Plan. All plan members hired before January 1, 2017, are required to participate in the Traditional Retirement Plan administered by the System. The members of the Traditional plan are required to contribute 6% of annual compensation. Effective in 2020, certain Fire union members, based on date of hire are required to contribute 6.5% of annual compensation. Effective in 2023, certain Police union members, based on date of hire are required to contribute 6.5% of annual compensation. The City is required to contribute at an actuarially determined rate; the rates for 2023 were 25.81% to 37.50%. Plan provisions and contribution requirements are established and can be amended by the City Council. System administrative costs are financed through investment earnings.

Contributions - Dual Retirement Plan. All plan members hired after January 1, 2017, except for Ann Arbor Police Officers' Association, Command Officers' Association of Michigan, and Fire union employees, are required to participate in a hybrid pension plan (Dual Retirement Plan) administered by the System. The Dual Retirement Plan is comprised of two components: a defined benefit plan and a defined contribution plan. Under the defined benefit plan, the City contributes at an actuarially determined rate and employees contribute 3% of their wages. Employees vest 100% in the Defined Benefit Plan after 10 years of service.

Under the defined contribution plan, the employees contribute 3% of their wages and the employer contributes 5.2% for General members and 6.88% for Assistant Fire Chiefs and Deputy Police Chiefs. Employees vest 100% in the defined contribution plan after five years of service. In accordance with these requirements, the City had net contributions (contributions less forfeitures) of \$935,109 and the employees contributed \$554,127 for the year ended June 30, 2023.

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Notes To Financial Statements

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting. The System's financial statements are prepared on the accrual basis of accounting. Member contributions are recognized in the period in which they 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. The System's investments are stated at fair value which is determined as follows: (a) short-term investments are reported at cost, which approximates fair value; (b) securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates; (c) investments for which market quotations are not readily available are valued at their fair values as determined by the custodian under the direction of the System's governing body, with the assistance of a valuation service; and (d) cash deposits are reported at carrying amounts which reasonably approximates fair value.

Capital Assets. Capital assets are reported (net of accumulated depreciation) in the statement of plan net position. Capital assets are defined by the System as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset life are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Capital assets are depreciated using the straight-line method over the following estimated useful lives: building and improvements - 40 years.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make significant estimates and assumptions that could 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.

3. DEPOSITS, INVESTMENTS, AND SECURITIES LENDING

The System does not maintain any checking or other demand/time deposit accounts. Amounts reported as cash or equity in the City's pooled cash and investments in the statements of fiduciary net position are composed entirely of amounts held by the City as part of its cash pool. As a result, the insured and uninsured amounts related to these accounts cannot be determined.

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 governing body has the responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to assist in managing the System's investments; all investment decisions are subject to Michigan law and the investment policy established by the governing body.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Notes To Financial Statements

Investment allocation policy. The System’s policy in regard to the allocation of invested assets is established and may be amended by the Retirement System Board of Trustees. The policy pursues an investment strategy that protects the financial health of the System and reduces risk through the prudent diversification of the portfolio across a broad selection of distinct asset classes. System assets will be invested in the broad investment categories and asset classes to achieve the allocation targets below. Recognizing that asset returns may vary, causing fluctuations in the relative dollar value levels of assets within classes, the System may not maintain strict adherence to the targets in the short-term, but may allow the values to fluctuate within these ranges. Over the long-term, the System will strive to adhere to the given targets as financially practicable and move toward target allocations in a prudent manner consistent with its fiduciary duty.

The adopted asset allocation policy as of June 30, 2023, is as follows:

Asset Class	Target Allocation	Allocation Range
Equities		
Domestic equities	36%	25% to 42%
Developed foreign equities	14%	9% to 17%
Emerging markets equities	7%	0% to 10%
Private equities	7%	0% to 10%
	64%	
Fixed income		
Investment grade bonds	10%	6% to 22%
Private debt	7%	0% to 10%
	17%	
Other investments		
Real estate	9%	2% to 12%
Infrastructure	7%	0% to 10%
Natural resources	3%	0% to 5%
	19%	
Total investments	100%	

The investment allocation policy will be reviewed periodically to ensure that the objectives and constraints remain relevant. However, the Trustees recognize the need for a stable long-term policy for the System and major changes to this policy will be made only when significant developments in the circumstances, objectives or constraints of the System occur.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Notes To Financial Statements

Investment holdings. The System's investments are held by an independent trust company. Following is a summary of the System's investments as of June 30, 2023:

	Domestic	Foreign	Total	On Loan
Equities				
Common stock	\$ 155,834,584	\$ 838,090	\$ 156,672,674	\$ 4,436,819
Common stock funds	66,330,343	119,830,194	186,160,537	-
Private equities	45,178,899	-	45,178,899	-
Equity mutual funds	3,147,193	1,109,762	4,256,955	-
	<u>270,491,019</u>	<u>121,778,046</u>	<u>392,269,065</u>	<u>4,436,819</u>
Fixed income				
Government agency funds	29,038,321	-	29,038,321	-
Corporate bonds	-	4,492,839	4,492,839	-
Corporate bond funds	32,666,491	-	32,666,491	-
Private credit	17,687,124	-	17,687,124	-
Fixed income mutual funds	803,158	105,070	908,228	-
	<u>80,195,094</u>	<u>4,597,909</u>	<u>84,793,003</u>	<u>-</u>
Other				
Infrastructure	4,948,611	36,182,809	41,131,420	-
Real estate funds and REITs	67,553,331	-	67,553,331	-
Real estate - private credit	4,838,194	-	4,838,194	-
Mutual funds - other	378,890	-	378,890	-
Short-term investment funds	21,630,558	-	21,630,558	-
	<u>99,349,584</u>	<u>36,182,809</u>	<u>135,532,393</u>	<u>-</u>
Total investments	<u>\$ 450,035,697</u>	<u>\$ 162,558,764</u>	<u>\$ 612,594,461</u>	<u>\$ 4,436,819</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 requires that securities be held in trust by a third-party institution in the System's name. As such, 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 are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book form.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Notes To Financial Statements

Credit Risk. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Investments in any particular asset class may or may not be consistent with the objectives of the System. The investment policy statement specifically indicates permissible asset classes, including high yield fixed income and alternatives, in appropriate target percentages.

The System's investments in government agency funds, corporate bond funds, bank loan participation, private credit, and index linked government bonds (each of which are essentially funds) are not rated.

The System's fixed income securities consisted of the following at June 30, 2023:

Government agency funds	\$ 29,038,321
Corporate bonds	4,492,839
Corporate bond funds	32,666,491
Private credit	17,687,124
Fixed income mutual funds	<u>908,228</u>
Total fixed income	<u>\$ 84,793,003</u>

The System's investments in corporate bond funds and hedge funds are not rated; also, the other fixed income securities at June 30, 2023 were essentially in "funds" and therefore not rated, with the exception of corporate bonds.

Concentration of Credit Risk. Concentration of credit risk is the risk of loss attributed to the magnitude of the System's investment in a single issuer. The System's investment policy requires that no more than 5% of the total fund be invested in any one company or governmental agency.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System's investment policy requires a maximum term to maturity of 30 years for any single fixed income security. The System's investment policy does not address weighted average portfolio maturities.

As of June 30, 2023, weighted average maturity of the System's corporate bonds was 6.3 years.

Inasmuch as all of the debt or fixed income securities as of June 30, 2023, except for the corporate bonds, are essentially held in funds by the portfolio managers, maturity information is not available.

Rate of Return. For the year ended June 30, 2023, the annual money-weighted rate of return on plan investments, net of investment expenses, was 10.80%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Notes To Financial Statements

Securities Lending. A contract approved by the System's Board of Trustees, permits the System to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The System's custodial trust company manages the securities lending program and receives securities, cash or irrevocable bank letters of credit as collateral. The collateral securities cannot be pledged or sold by the System unless the borrower defaults. Collateral is initially pledged at 102 percent of the market value of the securities lent and may not fall below 100 percent during the term of the loan. There are no restrictions on the amount of securities that can be loaned.

At year end, the System has no credit risk exposure to borrowers because the amounts the System owes the borrowers exceeds the amounts the borrowers owe the System. The contract with the System's custodian requires it to indemnify the System if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the System for income distributions by the securities' issuers while the securities are on loan.

At June 30, 2023, the total collateral received from borrowers had a fair value of \$4,436,819, all of which was cash.

Fair Value Measurements. The System categorizes the fair value measurements of its investments within the fair value hierarchy established by generally accepted accounting principles. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs – other than quoted prices – included within Level 1 that are observable for the asset or liability, either directly or indirectly. Finally, Level 3 inputs are unobservable and are based on estimates and assumptions. These levels are determined by the System's investment manager at the fund level based on a review of the investment's class, structure, and what kind of securities are held in funds. The investment manager will request the information from the fund manager, if necessary.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Notes To Financial Statements

The System had the following recurring fair value measurements as of June 30, 2023:

	Level 1	Level 2	Level 3	Total
Equities				
Common stock	\$ 156,672,674	\$ -	\$ -	\$ 156,672,674
Common stock funds	71,412,679	114,747,858	-	186,160,537
Private equities	-	-	45,178,899	45,178,899
Equity mutual funds	4,256,955	-	-	4,256,955
	<u>232,342,308</u>	<u>114,747,858</u>	<u>45,178,899</u>	<u>392,269,065</u>
Fixed income				
Government agency funds	-	29,038,321	-	29,038,321
Corporate bonds	-	-	4,492,839	4,492,839
Corporate bond funds	-	32,666,491	-	32,666,491
Private credit	-	-	17,687,124	17,687,124
Fixed income mutual funds	908,228	-	-	908,228
	<u>908,228</u>	<u>61,704,812</u>	<u>22,179,963</u>	<u>84,793,003</u>
Other				
Infrastructure	-	5,312,172	35,819,248	41,131,420
Real estate funds and REITs	-	-	67,553,331	67,553,331
Real estate - private credit	-	-	4,838,194	4,838,194
Mutual funds - other	378,890	-	-	378,890
Short-term investment funds	21,630,558	-	-	21,630,558
	<u>22,009,448</u>	<u>5,312,172</u>	<u>108,210,773</u>	<u>135,532,393</u>
Grand Total	<u>\$ 255,259,984</u>	<u>\$ 181,764,842</u>	<u>\$ 175,569,635</u>	<u>\$ 612,594,461</u>

4. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2023, was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
Capital assets being depreciated - Buildings and improvements	\$ 471,556	\$ -	\$ -	\$ 471,556
Less accumulated depreciation for - Buildings and improvements	(159,450)	(11,852)	-	(171,302)
Total capital assets, net	<u>\$ 312,106</u>	<u>\$ (11,852)</u>	<u>\$ -</u>	<u>\$ 300,254</u>

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Notes To Financial Statements

5. NET PENSION LIABILITY OF THE CITY

The components of the net pension liability of the City at June 30, 2023, are as follows:

Total pension liability	\$ 668,168,811
Plan fiduciary net position	<u>605,610,308</u>
City's net pension liability	<u><u>\$ 62,558,503</u></u>
 Plan fiduciary net position as a percentage of the total pension liability	 90.64%

Actuarial Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2022 (and rolled forward to June 30, 2023), using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.5 percent
Salary increases	3.5 percent, average, including inflation
Investment rate of return	6.7 percent, net of pension plan investment expense, including inflation

Healthy mortality rates (both pre and post retirement) were based on the Pub-2010 General Employee Mortality Tables, amount-weighted, and projected with mortality improvements using the fully generational MP-2021 projection scale from a base year of 2010. Disabled retirement mortality rates were based on the same mortality tables.

The actuarial assumptions used in the June 30, 2023 GASB Statement No. 67 and 68 valuation were based on the results of an actuarial experience study for the period July 1, 2017 through June 30, 2022.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Notes To Financial Statements

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan’s target asset allocation as of June 30, 2023 (see the discussion of the System’s investment allocation policy) are summarized in the following table:

Asset Class	Long-term Expected Real Rate of Return	Long-term Expected Real Rate of Return	Money- Weighted Rate of Return
Equities			
Domestic equities	36.00%	5.90%	2.12%
Developed foreign equities	14.00%	7.00%	0.98%
Emerging markets equities	7.00%	7.20%	0.50%
Private equities	7.00%	8.20%	0.57%
Fixed income			
Investment grade bonds	10.00%	2.00%	0.20%
Private debt	7.00%	6.20%	0.43%
Other investments			
Real estate	9.00%	5.10%	0.46%
Infrastructure (core private)	7.00%	5.10%	0.36%
Natural resources	3.00%	5.90%	0.18%
	<u>100.0%</u>		<u>5.80%</u>
Inflation			2.60%
Risk adjustments			<u>-1.88%</u>
			<u>6.70%</u>

Discount Rate. The discount rate used to measure the total pension liability was 6.7 percent. The projection of cash flows used to determine the discount rate assumed that plan 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 those assumptions, the 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.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Notes To Financial Statements

Sensitivity of the Net Pension Liability to Changes in the Discount Rate. The following presents the net pension liability of the City, calculated using the discount rate of 6.7 percent, as well as what the City's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.7 percent) or 1-percentage-point higher (7.7 percent) than the current rate:

	1% Decrease (5.7%)	Current Discount (6.7%)	1% Increase (7.7%)
City's net pension liability	\$ 136,415,120	\$ 62,558,503	\$ 425,739

6. RECONCILIATION OF PLAN FIDUCIARY NET POSITION

As mentioned in the Contribution section in Note 1, the System modified the retirement plan in 2017 to a hybrid retirement plan that operates as both a defined contribution and benefit plan for participants. The addition of the new plan requires reconciliation of the plan fiduciary net position.

The reconciliation of the "Plan fiduciary net position per Schedule of Changes in the City's Net Position and Related Ratios" and "Net position per Statement of Fiduciary Net Position" of the System at June 30, 2023, is as follows:

Plan fiduciary net position per Schedule of Changes in the City's Net Position and Related Ratios	\$ 605,610,308
Defined contribution plan assets	5,544,073
Current year GASB 67 expense	234,283
Current year GASB 74 expense	<u>225,717</u>
Net position per Statement of Fiduciary Net Position	<u><u>\$ 611,614,381</u></u>

7. CORONAVIRUS (COVID-19)

In March 2020, the World Health Organization declared the novel coronavirus outbreak (COVID-19) to be a global pandemic. The pandemic has resulted in operational challenges for the System. At this time, management does not believe that the ongoing negative financial impact related to the pandemic, if any, would be material to the System.



REQUIRED SUPPLEMENTARY INFORMATION

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**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Required Supplementary Information

Schedule of Changes in the City's Net Pension Liability (Asset) and Related Ratios
Last Ten Fiscal Years

	Fiscal Year Ended June 30,									
	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Change in total pension liability										
Service cost	\$ 10,180,055	\$ 9,923,074	\$ 10,172,596	\$ 9,922,176	\$ 9,783,377	\$ 9,403,000	\$ 8,869,000	\$ 8,729,000	\$ 9,760,000	\$ 9,802,000
Interest	42,110,130	42,015,152	41,832,292	40,637,790	40,055,937	38,552,000	37,755,000	36,925,458	35,978,096	34,400,755
Changes of benefit terms	(436,454)	-	-	-	-	-	-	-	-	-
Differences between expected and actual experience	10,268,668	(5,613,016)	(5,188,914)	5,221,388	(2,982,853)	15,517,000	3,488,000	(3,826,000)	279,000	3,834,000
Changes of assumptions	13,970,559	7,273,056	6,182,687	1,248,573	-	4,342	30,337	-	-	-
Benefit payments, including refunds of member contributions	(44,201,468)	(42,549,302)	(40,576,348)	(39,605,298)	(37,622,046)	(36,715,000)	(35,436,000)	(33,960,032)	(32,667,512)	(32,011,444)
Net change in total pension liability	31,891,490	11,048,964	12,422,313	17,424,629	9,234,415	26,761,342	14,706,337	7,868,426	13,349,584	16,025,311
Total pension liability, beginning	636,277,321	625,228,357	612,806,044	595,381,415	586,147,000	559,385,658	544,679,321	536,810,895	523,461,311	507,436,000
Total pension liability, ending (a)	668,168,811	636,277,321	625,228,357	612,806,044	595,381,415	586,147,000	559,385,658	544,679,321	536,810,895	523,461,311
Change in plan fiduciary net position										
Contributions - employer	14,638,512	16,255,245	15,284,295	14,124,165	13,621,926	13,446,000	13,253,000	13,352,412	13,091,474	11,227,290
Contributions - member	3,295,342	3,222,809	3,194,016	3,164,729	3,264,590	3,185,000	3,325,000	3,139,266	3,013,353	2,948,177
Net investment income (loss)	61,021,956	(31,380,434)	136,319,258	23,143,999	30,599,351	33,235,000	54,243,000	2,434,399	20,144,251	60,253,683
Benefit payments, including refunds of member contributions	(44,201,468)	(42,549,302)	(40,576,348)	(39,605,298)	(37,622,046)	(36,715,000)	(35,436,000)	(33,960,032)	(32,667,512)	(32,011,444)
Administrative expense	(783,097)	(702,218)	(604,004)	(689,228)	(671,194)	(694,000)	(748,000)	(719,621)	(683,980)	(644,051)
Other	464,347	78,468	(43,329)	(360,337)	(29,397)	299,982	16,337	-	-	-
Net change in plan fiduciary net position	34,435,592	(55,075,432)	113,573,888	(221,970)	9,163,230	12,756,982	34,653,337	(15,753,576)	2,897,586	41,773,655
Plan fiduciary net position, beginning, before restatement	571,174,716	626,250,148	512,676,260	512,898,230	503,735,000	491,273,658	456,620,321	472,373,897	469,685,311	427,911,656
Restatement for pension liability	-	-	-	-	-	-	-	-	(209,000)	-
Restatement for net OPEB liability	-	-	-	-	-	(295,640)	-	-	-	-
Plan fiduciary net position, ending (b)	605,610,308	571,174,716	626,250,148	512,676,260	512,898,230	503,735,000	491,273,658	456,620,321	472,373,897	469,685,311
City's net pension liability (asset), ending (a)-(b)	\$ 62,558,503	\$ 65,102,605	\$ (1,021,791)	\$ 100,129,784	\$ 82,483,185	\$ 82,412,000	\$ 68,112,000	\$ 88,059,000	\$ 64,436,998	\$ 53,776,000
Plan fiduciary net position as a percentage of the total pension liability (asset)	90.64%	89.77%	100.16%	83.66%	86.15%	85.94%	87.82%	83.83%	88.00%	89.73%
Covered-employee payroll	\$ 63,136,097	\$ 62,187,947	\$ 60,232,543	\$ 57,970,915	\$ 57,077,636	\$ 55,459,000	\$ 53,583,000	\$ 50,057,000	\$ 49,638,000	\$ 47,956,745
City's net pension liability (asset) as a percentage of covered payroll	99.09%	104.69%	-1.70%	172.72%	144.51%	148.60%	127.11%	175.92%	129.81%	112.13%

See notes to required supplementary information.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Required Supplementary Information

Schedule of City Contributions

Last Ten Fiscal Years

Fiscal Year Ended	Actuarially Determined Contribution	Contributions in Relation to the Actuarially Determined Contribution	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
6/30/2014	\$ 11,217,000	\$ 11,227,290	\$ (10,290)	\$ 47,956,745	23.4%
6/30/2015	12,327,000	13,091,474	(764,474)	49,638,000	26.4%
6/30/2016	12,233,000	13,352,412	(1,119,412)	50,057,000	26.7%
6/30/2017	11,348,853	13,253,000	(1,904,147)	53,583,000	24.7%
6/30/2018	11,757,000	13,446,000	(1,689,000)	55,459,000	24.2%
6/30/2019	13,464,778	13,621,926	(157,148)	57,077,636	23.9%
6/30/2020	14,092,966	14,124,165	(31,199)	57,970,915	24.4%
6/30/2021	15,251,454	15,284,295	(32,841)	60,232,543	25.4%
6/30/2022	16,125,556	16,255,245	(129,689)	62,187,947	26.1%
6/30/2023	14,301,037	14,638,512	(337,475)	63,136,097	23.2%

See notes to required supplementary information.

**CITY OF ANN ARBOR, MICHIGAN
EMPLOYEES' RETIREMENT SYSTEM**

Required Supplementary Information

Schedule of Investment Returns
Last Ten Fiscal Years

Fiscal Year Ended June 30,	Annual Money- Weighted Rate of Return, Net of Investment Expense
2014	14.01%
2015	4.35%
2016	0.50%
2017	11.93%
2018	7.02%
2019	6.07%
2020	4.45%
2021	26.74%
2022	-5.19%
2023	10.80%

CITY OF ANN ARBOR, MICHIGAN EMPLOYEES' RETIREMENT SYSTEM

Notes to Required Supplementary Information

Employees' Retirement System

Pension Information

GASB 67 was implemented in fiscal year 2014. These schedules are being built prospectively.

Notes to the Schedule of Changes in Net Pension Liability (Asset) and Related Ratios

Changes in assumptions The significant changes in assumptions for the fiscal year ended June 30, 2023, were primarily related to revised assumptions adopted by the Board pursuant to the five-year experience study covering the period July 1, 2017 to June 30, 2022 and a decrease in the discount rate from 6.8% to 6.7%.

The significant changes in assumptions for the fiscal year ended June 30, 2022, were primarily related to the decrease in the discount rate used to measure the total pension liability from 6.9% to 6.8%.

The significant changes in assumptions for the fiscal year ended June 30, 2021, were primarily related the decrease in the discount rate used to measure the total pension liability from 7.0% to 6.9%.

The significant changes in assumptions for the fiscal year ended June 30, 2020, were primarily related to changes in the inflation rate and wage rate assumptions, and updating the mortality tables used from RP-2000 to RP-2014.

Notes to Schedule of Contributions

Valuation date Actuarially determined contribution rates are calculated as of June 30 that is 12 months prior to the beginning of the fiscal year for which the contributions are reported (June 30, 2021, for the fiscal year ended June 30, 2023).

Methods and assumptions used to determine contribution rates:

Actuarial cost method	Entry age normal
Amortization method	Level dollar, closed
Remaining amortization period	20 years closed until 15 years, at which time a 15 year open period is used
Asset valuation method	5-year smoothed market
Inflation	2.5% No explicit price inflation assumption is used in this valuation
Salary increases	General: 4.0%-7.5%
	Police: 5.3%-11.0%
	Fire: 5.4%-10.8%
Investment rate of return	6.80% net of pension plan investment expense, including inflation
Retirement Age	Experienced-based table of rates that are specific to the type of eligibility condition
Mortality rates	RP-2014 Healthy Employees and Annuitants, adjusted back to 2006, generational under projection scale MP-2017

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

October 18, 2023

To the Board of Trustees
City of Ann Arbor Employees' Retirement System
Ann Arbor, Michigan

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the **City of Ann Arbor Employees' Retirement System** (the "System"), a fiduciary component unit of the City of Ann Arbor, Michigan, as of and for the year ended June 30, 2023, and the related notes to the financial statements, which collectively comprise the basic financial statements, and have issued our report thereon dated October 18, 2023.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) as a basis for designing the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that have not been identified.



Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Rehmann Lobson LLC