

**MIDLAND FIREMEN'S RELIEF  
AND RETIREMENT FUND**

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FINANCIAL STATEMENTS  
and  
INDEPENDENT AUDITOR'S REPORT

For the Year Ended December 31, 2014

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# MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

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## INDEPENDENT AUDITOR'S REPORT

Board of Trustees  
Midland Firemen's Relief and Retirement Fund  
Midland, Texas

We have audited the accompanying financial statements of the Midland Firemen's Relief and Retirement Fund (the Plan), which comprise the statement of fiduciary net position as of December 31, 2014, and the related statement of changes in fiduciary net position for the year then ended and the related notes to the financial statements.

### **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 error or fraud.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Midland Firemen's Relief and Retirement Fund as of December 31, 2014, and the change in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3 through 6 and the schedule of changes in net pension liability and related ratios on pages 19 through 22 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.

*Davis Kinard & Co., PC*  
Certified Public Accountants

October 26, 2015  
Abilene, Texas

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2014 and 2013**

**Introduction:**

The Midland Firemen's Relief and Retirement Fund (the Plan) is a single-employer, defined benefit pension plan covering substantially all firemen employed by the City of Midland, Texas. It is subject to the provisions of the Texas Local Firefighters' Retirement Act (Article 6243e, Vernon's Texas Civil Statutes 45th Legislature 1937) as amended.

As management of the Plan, we offer readers of the Plan financial statements, this narrative overview and analysis of the financial activities of the Plan for the fiscal years ended December 31, 2014 and 2013.

**Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the Plan's financial statements. The Plan's financial statements are comprised of statements of Fiduciary Net Position, statements of changes in Fiduciary Net Position, and notes to the financial statements. This report also contains other required supplementary information in addition to the financial statements themselves.

**Statement of Fiduciary Net Position**

The Fiduciary Net Position is designed to provide a broad overview of the Plan's finances in a manner similar to other pension funds. The Fiduciary Net Position presents the financial position of the Plan. The financial position is simply all of the Plan's assets and liabilities, with the difference between the two reported as Fiduciary Net Position. This audit report represents the Fiduciary Net Position of the Plan.

**Statement of Changes in Fiduciary Net Position**

The statement of changes in Fiduciary Net Position presents the additions to and deductions from the Plan's Fiduciary Net Position during the year. The additions to Fiduciary Net Position are divided into two types of categories, contributions and investment income (loss). Contributions are shown from both employer and plan members. Net investment income (loss) is broken down by net appreciation (depreciation) in fair value of investments, interest, partnership income and dividend income, less investment expenses. The primary deductions are to pay benefits, which are the Plan's primary purpose. Deductions also include refunds to members who leave the Plan and administrative expenses. The change in the Plan's Fiduciary Net Position during the year is added to or subtracted from the beginning balance of the Plan's Fiduciary Net Position to obtain the balance of Plan's Fiduciary Net Position at the end of the year. This figure ties directly to the last line of the statement of the Plan's Fiduciary Net Position.

**Notes to the Financial Statements**

The notes to the financial statements are an integral part of the financial statements. They provide additional information that is essential to a full understanding of the data provided in the financial statements. Among other matters, the notes describe: (a) the Plan's purpose and its membership, (b) the significant accounting policies used to prepare the financial statements, (c) the nature of the Plan, including the membership and benefit provisions and contribution requirements, and (d) the Plan's investment authority and policies, how investments and related documentation are safeguarded, and selected details about various investment activity and balances.

The notes to the financial statements can be found on pages 9 through 19 of this report.

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2014 and 2013**

**Required Supplementary Information**

To provide actuarially determined information about the Plan, this report includes schedules of historical trend information in the required supplementary information section. Those schedules, the census, and the schedule of changes in Net Pension Liability, provide information to help you understand the changes in the actuarial funding and the funded status of the Plan over time. Please note that the actuarial information is based upon assumptions about future events, and therefore, the figures presented are necessary estimates.

The schedule of changes in Net Pension Liability provides information about the progress made to accumulate sufficient assets to pay benefits when due. It presents the funded status of the Plan by comparing the actuarial value of the assets to the Net Pension Liability.

The schedule of actuarial methods and assumptions, provide the actuarial information used to determine the information presented in the schedule of changes in pension liability.

**Statement of Fiduciary Net Position Analysis**

The following condensed statements of the Fiduciary Net Position and changes in Fiduciary Net Position present financial information comparing 2014 and 2013 information. This information comes from the statements of Fiduciary Net Position and changes in Plan Net Position for the years then ended.

The Plan's Fiduciary Net Position was \$82,552,420 and \$80,950,814 as of 2014 and 2013, respectively. In 2014 there was an increase of \$1,601,606 or 2% over the previous year's balance of \$80,950,814. In 2013 there was an increase of \$8,838,338 or 12% over the previous year's balance of \$72,112,476. In 2012 there was an increase of \$6,387,750 or 10% over the previous year's balance of \$65,724,726.

The largest portion of the Plan's total assets is reflected in its common stocks category. These assets are to be used for pension benefits in the future.

**CONDENSED STATEMENT OF FIDUCIARY NET POSITION**

	<u>2014</u>	<u>2013</u>
<b>ASSETS</b>		
Cash and short-term investments	\$ 6,312,273	\$ 7,030,886
Investments	76,125,138	73,760,485
Receivables	<u>197,610</u>	<u>212,103</u>
Total assets	<u>82,635,021</u>	<u>81,003,474</u>
<b>LIABILITIES</b>		
Accounts payable	<u>82,601</u>	<u>52,660</u>
Total liabilities	<u>82,601</u>	<u>52,660</u>
<b>FIDUCIARY NET POSITION</b>	<u>\$ 82,552,420</u>	<u>\$ 80,950,814</u>

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2014 and 2013**

**Statement of Fiduciary Net Position Analysis (Continued)**

**CONDENSED STATEMENT OF CHANGES IN FIDUCIARY NET POSITION**

	<u>2014</u>	<u>2013</u>
<b>ADDITIONS</b>		
Contributions	\$ 5,373,610	\$ 4,574,540
Net investment income (loss)	<u>2,751,744</u>	<u>10,662,199</u>
Total additions	<u>8,125,354</u>	<u>15,236,739</u>
<b>DEDUCTIONS</b>		
Benefits paid directly to participants	5,213,958	4,790,206
Lump sum distributions	1,087,085	1,399,656
Wages expense and taxes	134,033	128,573
Administrative expenses	<u>88,672</u>	<u>79,966</u>
Total deductions	<u>6,523,748</u>	<u>6,398,401</u>
<b>NET INCREASE IN FIDUCIARY NET POSITION</b>	1,601,606	8,838,338
<b>FIDUCIARY NET POSITION AT BEGINNING OF YEAR</b>	<u>80,950,814</u>	<u>72,112,476</u>
<b>FIDUCIARY NET POSITION AT END OF YEAR</b>	<u>\$ 82,552,420</u>	<u>\$ 80,950,814</u>

As of December 2014, the Plan had 13 money managers managing seven different types of investment instruments within its investment portfolio. Each type of investment within the different asset classes had a target allocation of no more than 40% and not less than 1%. Total amount of each type of investment ranged from a high of \$22,354,155, in common stock to a low of \$519,805 in municipal bonds. The actuarial assumption used by the Plan is an 8% return.

As of December 2013, the Plan had 15 money managers managing seven different types of investment instruments within its investment portfolio. Each type of investment within the different asset classes had a target allocation of no more than 40% and not less than 1%. Total amount of each type of investment ranged from a high of \$21,944,092 in mutual funds to a low of \$485,515 in municipal bonds. The actuarial assumption used by the Plan is an 8% return.

**Financial Highlights**

- The Fiduciary Net Position at the close of the fiscal years ended December 31, 2014 and 2013, were \$82,552,420 and \$80,950,814, respectively.
- The Fiduciary Net Position increased in 2014 by \$1,601,606 and increased in 2013 by \$8,838,338. The increases were due mainly to the change in net appreciation in fair value of investments.
- In 2014 and 2013, the Plan reported cash and short-term investments of \$6,312,273 and \$7,030,886, respectively.
- Receivables at the end of the fiscal years 2014 and 2013 were \$197,610 and \$212,103, respectively.

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
December 31, 2014 and 2013**

**Funding Progress**

The Plan has a contract with John M. Crider, Jr., Consulting Actuary, who evaluates that the contribution commitment by the firefighters and the City of Midland provides an adequate financing arrangement. This financing arrangement includes consideration of the Plan's funding status on a going-concern basis and progress made in accumulating sufficient assets to pay benefits when due. Using the entry age actuarial cost method, the Plan's normal cost is determined as a percentage of payroll. The excess of the total contribution rate over the normal cost rate is used to amortize the Plan's unfunded actuarial accrued liability (UAAL), and the number of years needed to amortize the Plan's UAAL is determined using a level percentage of payroll method. For years in which actuarial valuations are not performed, estimates are made using the actuarial methods and principles. The following are summary results from the valuation of January 1, 2014, the latest version:

- Using the market value of assets, the approximate annual rates of return for the years ended December 31, 2007, through 2013, were 10.9%, -20.0%, 12.9%, 11.9%, -2.9%, 11.2% and 14.7% respectively. The average rate of return for the five-year period ended December 31, 2013, was 9.3%.
- The combined member and City of Midland contribution rates as of January 1, 2014, were not capable of amortizing the Plan's UAAL. The amortization period as of January 1, 2014, however, was 59.1 years. The amortization period increased due to the rate of return on the actuarial value of assets, which was lower than assumed. The Plan had favorable demographic experience, however. The amortization period decreased between 2012 and 2014 due to the increase in City contributions and improving staffing levels.

If a plan's actuarial liabilities exceed the actuarial value of assets, the plan is said to have a UAAL. As of January 1, 2014, the Plan had a UAAL of \$38,963,054, an increase of \$10,871,087 compared to UAAL of \$28,091,967 as of January 1, 2012.

**Capital Assets and Debt Administration**

The Plan does not have any capital assets other than office equipment or have any outstanding long-term debt as of December 31, 2014 and 2013.

**Economic Factors**

The Plan's Board is continuing to review asset allocation in order to continue to meet the actuarial assumption as currently established. In addition, each of the various money managers is being benchmarked to current market conditions. By performing this type of benchmarking, it helps ensure that the best returns are being earned given the appropriate risk factors of that type of investment.

**Request for Information**

This financial report is designed to provide a general overview of the finances of the Plan. As the City of Midland serves as fiscal agent for the Plan, questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Midland Firemen's Relief and Retirement Fund, P.O. Box 4296, Midland, Texas, 79704.

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND**  
Midland, Texas

STATEMENT OF FIDUCIARY NET POSITION  
DECEMBER 31, 2014

ASSETS	
Cash and cash equivalents	\$ 6,312,273
Investments at fair value:	
Common stock	22,354,155
Foreign bonds	3,355,643
Corporate bonds	15,845,684
Mutual funds	4,539,021
Real estate	18,953,260
Hedge funds and venture capital	8,732,149
Government and agency obligations	1,825,421
Municipal bonds	<u>519,805</u>
Total investments	<u>76,125,138</u>
Receivables	
Accrued interest and declared dividends	<u>197,610</u>
Total receivables	<u>197,610</u>
TOTAL ASSETS	<u>82,635,021</u>
LIABILITIES	
Accounts payable	<u>82,601</u>
TOTAL LIABILITIES	<u>82,601</u>
NET POSITION RESTRICTED FOR PENSIONS	<u>\$ 82,552,420</u>

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

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND**  
Midland, Texas

**STATEMENT OF CHANGES IN FIDUCIARY NET POSITION**  
**FOR THE YEAR ENDED DECEMBER 31, 2014**

ADDITIONS:

Investment income:

Net appreciation in fair value of investments	\$ 1,422,909
Interest income	597,530
Dividend income	345,243
Partnership income	913,762
Less: investment expense	<u>(531,563)</u>

Net investment income 2,747,881

Other cash receipts 3,863

Contributions:

Plan members	2,055,503
Employer	<u>3,318,107</u>

Total contributions 5,373,610

Total additions 8,125,354

DEDUCTIONS:

Benefits paid including refunds of plan member contributions	6,301,043
Wages expense, benefits, and taxes	134,033
Administrative expenses	<u>88,672</u>

Total deductions 6,523,748

NET INCREASE IN NET POSITION 1,601,606

Net position restricted for pensions at beginning of year 80,950,814

NET POSITION RESTRICTED FOR PENSIONS  
AT END OF YEAR

\$ 82,552,420

# MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

## NOTE 1: *SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*

City of Midland firefighters are members of the locally administered Midland Firemen's Relief and Retirement Fund (the Plan), established under the authority of the Texas Local Fire Fighters' Retirement Act passed in 1937 by the Texas State Legislature. The Plan is not a component unit of the City of Midland, Texas.

The Plan is governed by seven trustees composed of the Mayor or his designee, the Director of Finance of the City of Midland or his designee, three firefighters elected by majority vote of firefighters, and two citizens who are not officers or employees of the municipality and who must be elected by the majority vote of the board of trustees. The State of Texas Pension Review Board monitors execution of the act.

The following are the significant accounting policies followed by the Plan:

### Basis of Accounting

The accompanying financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized when due and the employer and employee have made formal commitments to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

### Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

### Valuation of Investments

Investments in equity securities traded on international and national securities exchanges are valued based on the latest quoted market price as of each year-end. Investments that are not traded on a national securities exchange are valued at their fair values determined by the Trustees based on the market values of similar investments or on the basis of information obtained from qualified sources such as the custodial bank trust department, brokers, pricing services or appraisers. Fixed income securities are valued at broker quotes.

The Plan's investments in limited partnerships (reported in real estate and other equity investments) are valued at estimated fair value based on the Plan's proportionate share of the partnerships' fair value as recorded by the partnership. The Plan uses information provided by the limited partnership, such as audited financial statements of the limited partnership and other information accumulated by management pertinent to the investment, to estimate fair value. The limited partnerships allocate gains, losses, and expenses to the partners based on the ownership percentage as described in the partnership agreements. The Plan uses cost on some limited partnerships because management has determined this is the best indicator of fair market value. Estimates are used by management in determining the fair value of the Plan's investments in limited partnerships. The amount received upon sale of the investments may differ significantly from the recorded amount.

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### NOTE 1: *SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continued*

#### Investment Gains or Losses

Investment gains or losses arising from increases or decreases in the fair values from the beginning of the year to the end of the year and investment gains or losses arising from the sale or maturity of investments are reported as net appreciation or depreciation in the fair value of investments in the statement of changes in fiduciary net position.

#### Cash and Cash Equivalents

For financial reporting purposes a portion of the investment portfolio is classified as equivalent to cash. Cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less which present an insignificant risk of changes in value because of changes in interest rates.

#### Interest and Dividends Receivable

Interest income is recorded on an accrual basis. Dividends are recorded on the ex-dividend date. Recording activity in such a manner results in interest and dividends receivable.

#### Income Tax Status

The Plan obtained its latest determination letter dated October 25, 2011, in which the Internal Revenue Service stated that the Plan, as then designed, was in compliance with the applicable requirements under Section 401(a) of the Internal Revenue Code. The Plan has been amended since receiving the determination letter. However, the Plan administrator and the Plan's tax counsel believe that the Plan is currently designed and being operated in compliance with the applicable requirements of the Internal Revenue Code. Therefore, no provision for income taxes has been included in the Plan's financial statements.

### NOTE 2: *DESCRIPTION OF PLAN*

The following brief description of the Midland Firemen's Relief and Retirement Fund is provided for general information purposes only. Participants should refer to the Plan agreement for more complete information.

#### General

The Midland Firemen's Relief and Retirement Fund is a single employer, defined benefit plan covering substantially all firefighters employed by the City of Midland, Texas (the City). It is subject to the provisions of the Texas Local Firefighters' Retirement Act (Article 6243e, Vernon's Texas Civil Statutes 45th Legislature 1937) as amended.

All firefighters become members of the Plan as a condition of their appointment unless they are more than 35 years of age at the time they enter service.

# MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

## NOTE 2: DESCRIPTION OF PLAN – continued

### Plan Membership as of December 31, 2014

Retirees and beneficiaries currently receiving benefits	150
Terminated employees entitled to but not yet receiving benefits	9
Fully vested active employees	98
Partially vested active employees	0
Non-vested active employees	<u>108</u>
Total	365

### Contributions

All members are required to contribute a percentage of their total pay to the Plan. The member contribution rate was 13.2% for 2014. The City's contribution rate was 21.2% through September 30, 2014 and increased to 21.7% starting October 1, 2014. For the year 2014, Plan member and employer contributions of \$2,055,503 and \$3,318,107, respectively, were made.

### Administration

The Plan is administered by a Board of Trustees (the Board) which is authorized to determine all retirement applications, disability claims, and beneficiary designations.

### Pension Benefit Provisions

A member is eligible for service retirement upon completion of 20 years of service and attainment of age 50. Service retirement benefits are payable for the member's lifetime. Service retirement benefits are calculated as 75% of the retiree's highest 60-month average salary while employed and \$80 per month for each whole year of service in excess of 20 years of service. In the event that the member's death precedes that of the member's spouse, 75% of the member's pension will be continued to the spouse for the spouse's lifetime. A member who has completed at least 25 years of service is also eligible for the above service retirement benefit even though he or she has not yet attained age 50.

In addition to the regular service retirement benefit, a member who retires after attaining age 50 and completing 20 years of service will also receive a supplemental benefit of \$500 per month. The supplemental benefit is payable for the member's lifetime. In the event the member's death precedes that of his or her spouse, 75% of the supplemental benefit will be continued to the spouse for the spouse's lifetime. However, the supplemental benefit is not payable to members who take service retirement prior to age 50. In lieu of the monthly service retirement benefit described above, a member may elect to receive his or her benefits under one of the Deferred Retirement Option Plan (DROP) provisions.

Effective October 1, 2008, the participating members of the Plan voted to amend the plan document. The new plan provides that eligible firefighters and beneficiaries who are entitled to the cost of living adjustment will become payable to these individuals on August 1 following the fifth full audited year of receipt of benefits by a firefighter and following a firefighter's physical departure from the Fire Department.

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### NOTE 2: DESCRIPTION OF PLAN – continued

Effective November 1, 2002, the participating members of the Plan voted to amend the plan document. The new plan provides that under the DROP, and DROP Plan Benefits, Option 1 (Forward DROP), a firefighter must retire within three years of DROP election.

Upon retirement under Option 2 (Reverse DROP) of the DROP Plan Benefits, a firefighter may elect to receive 90% of his regular monthly benefit, including the Supplemental Retirement Benefit, if applicable (with all survivor benefits appropriately reduced) for life and a lump sum equal to 24 times this reduced benefit. This amount must be paid within three years in no more than three installments.

Under a third Option (Retroactive DROP) to the DROP Plan Benefits, the Retroactive DROP provides that if a firefighter has at least 20 years of service and is at least 50 years old the firefighter may, at any time after that, elect to retire and have his "effective retirement date" no earlier than the date he actually had at least 20 years of service and was at least 50 years old.

The period of time between his "effective retirement date" and his actual retirement date will be the DROP period and will not exceed three years. His monthly benefit will be calculated based upon his salary and service at the time of his "effective retirement date."

The sum of his employee contributions during the DROP period plus the product of his monthly benefit amount times the number of months of the DROP period will be paid to him on his actual retirement date or, at his election, within three years in no more than three installments. This amount will include interest at 4% compounded annually. Interest will be calculated using the balance at year-end.

The new plan also provides a fourth Option Combined (Forward and Retroactive) DROP Plan Benefit. The Combined (Forward and Retroactive) DROP option states that the firefighter must retire within three years of his Combined (Forward and Retroactive) DROP. The monthly benefit he will receive from the Plan will be determined based upon his salary and service at the beginning of his DROP period. At the conclusion of the DROP period, the firefighter will be paid an amount which is the sum of his employee contributions from the Forward DROP portion of the period plus the product of his monthly benefit amount (including the Supplemental Retirement Benefit, if applicable) times the number of months of the Forward DROP portion of the Combined (Forward and Retroactive) DROP period. In addition, a monthly benefit calculated based upon the firefighter's salary and service at the time of his "effective retirement date" consisting of his contributions during the Retroactive portion of the Combined (Forward and Retroactive) DROP period plus the product of his monthly benefit amount (including the Supplemental Retirement Benefit, if applicable) times the number of months of the Retroactive DROP period.

This Combined (Forward and Retroactive) DROP amount shall include interest at an annual rate of 4% determined as of the end of each year or partial year of the Combined (Forward and Retroactive) DROP period and may be paid to the retired firefighter on his actual retirement date or, at his election, within three years in no more than three installments. Interest will be calculated using the balance at year-end. No interest shall be paid after the conclusion of the DROP period.

A member is eligible for early retirement upon completion of 20 years of service and attainment of age 45. Early retirement benefits are payable for the member's lifetime. Early retirement benefits are calculated as a percentage of the retiree's highest 60-month average salary while employed and an additional benefit each month for each year of service in excess of 20 years of service. In the event the member's death precedes that of

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### NOTE 2: *DESCRIPTION OF PLAN – continued*

his spouse, 75% of the member's pension will be continued to the member's spouse for the spouse's lifetime. The supplemental benefit is not payable to members who take early retirement.

An active member who becomes disabled for either physical or mental reasons (except for a pre-existing condition) may receive a monthly disability benefit. Disability benefits are payable in the same form as service retirement benefits. However, disability benefits stop if a member recovers to the point the member no longer meets the definition of disability under the Plan.

If a member dies while in active service, the widow (or widower) will receive an immediate monthly benefit, payable for as long as the widow (or widower) is living. The amount of the benefit will be equal to 75% of the service retirement the member would have been entitled to receive based on the member's salary and service at the time of the member's death. In addition, a \$10,000 lump sum benefit is payable to the designated beneficiary of a member who dies before retirement.

A Plan member who terminates employment after completing at least ten years of service, but prior to the date the member completes 20 years of service, will be entitled to receive a monthly benefit starting on the date the member would have both attained age 50 and completed 20 years of service had the member remained in active service with the fire department. However, this benefit will not commence later than the date the member reaches age 60. A Plan member who terminates employment prior to completing ten years of service will be entitled to the return of the excess of the member's contributions to the fund over the amount of any benefits the member has received from the fund.

In lieu of the monthly service, disability or vested termination benefit described above, a member may elect to receive a modified monthly retirement benefit payable for his or her lifetime with 100% of such modified monthly amount continued for as long as either the member or the member's spouse is living. Such election does not affect the supplemental benefit, 75% of which is continued to the surviving spouse for the lifetime of the surviving spouse.

The funding policy of the Plan requires contributions by the firefighters and the City, see Note 2 - Contributions.

While the contribution requirements are not actuarially determined, state law requires that each plan of benefits adopted by the Plan must be approved by a qualified actuary. The actuary certifies that the contribution commitment by the firefighters and the City provides an adequate financing arrangement. This financing arrangement includes consideration of the Plan's funding status on a going-concern basis and progress made in accumulating sufficient assets to pay benefits when due. Using the entry age actuarial cost method, the Plan's normal cost is determined as a percentage of payroll. The excess of the total contribution rate over the normal cost rate is used to amortize the Plan's UAAL, and the number of years needed to amortize the Plan's UAAL is determined using a level percentage of payroll method. For years in which actuarial valuations are not performed, estimates are made using the actuarial methods and principles.

### Termination of the Plan

A retirement system for a fire department not consisting exclusively of volunteers may not be terminated or merged into another retirement system without the approval of the Board of Trustees of the retirement system and the approval of the participating members of the system in the manner described by subdivision (2) of Subsection (b) of Section 7 of this Act provided 51% of the volunteers first petition the Board for such a change.

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### NOTE 2: DESCRIPTION OF PLAN – continued

The priority order of participants' claims to the Plan's assets upon Plan termination is pursuant to the Texas Local Fire Fighters' Retirement Act (Article 6243e, Vernon's Texas Civil Statutes 45th Legislature 1937) as amended.

### NOTE 3: CASH AND INVESTMENTS

Substantially all of the Plan's investments are held by its trustee/custodian. The Plan's Board of Trustees authorizes various portfolio managers to manage investments within certain policies as set forth by the Board. These policies mandate a diversified portfolio, which includes investments, either directly or in commingled accounts, in real estate, cash, money market funds, bonds, alternative investments, and equity securities.

Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment to GASB Statement No. 3* (GASB 40), addresses common deposit and investment risks including custodial credit risk, credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. Required disclosures related to these risks are presented below.

As required by GASB 40, investments included in assets whose use is limited and long-term investments are categorized by investment type. As of December 31, 2014, the Plan had the following debt securities and their related maturities, respectively:

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More Than 10
Foreign bonds	\$ 3,355,643	\$ 954,009	\$ 814,199	\$ 1,328,491	\$ 258,944
Corporate bonds	15,845,684	1,469,397	3,789,989	3,416,665	7,169,633
U.S. gov't securities	1,825,421	173,111	1,435,352	216,958	-
Municipal bonds	519,805	-	519,805	-	-
<b>Total Fair Value</b>	<b>\$ 21,546,553</b>	<b>\$ 2,596,517</b>	<b>\$ 6,559,345</b>	<b>\$ 4,962,114</b>	<b>\$ 7,428,577</b>

The Plan's investment policies are governed by state statutes and by Board adoption. Cash funds are deposited in Federal Deposit Insurance Corporation insured banks. The Plan is authorized to use demand accounts and certificates of deposit. Permissible investments include obligations of the U.S. Treasury and government agencies, commercial paper, and certain repurchase agreements.

*Custodial Credit Risk* – Custodial credit risk is the risk that in the event of failure of the counterparty, the Plan would not be able to recover the value of its investments. The Plan does not have a formal policy for custodial credit risk. As of December 31, 2014, all investments are registered in the name of the Midland Firemen's Relief and Retirement Plan or in the name of the Plan's custodian, established through a master trust custodial agreement, with the exception of investments in alternative investments and commingled funds, which are recorded as hedge funds and venture capital in the accompanying statement of fiduciary net position.

*Interest Rate Risk* – In compliance with the Plan's investment policy, the Plan minimizes the interest rate risk related to the decline in fair value of securities due to rising interest rates in the portfolio by structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the secondary market prior to maturity and monitoring credit ratings of portfolio positions.

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### NOTE 3: CASH AND INVESTMENTS – continued

The Plan's investments in U.S. and foreign government agency obligations are subject to credit risk. Under the Texas Local Firefighters' Retirement Act, the Board's general investment policy is to apply the following prudent-person rule: Investments are made as a prudent-person would be expected to act, with discretion and intelligence, to seek reasonable income and preserve capital. In terms of diversification, the Plan should not invest more than 5% of the total assets in the stock or bonds of one company.

*Credit Risk* – Under the Texas Local Firefighters' Retirement Act, the Board's general investment policy is to apply the prudent-person rule. As a matter of course, the Board expects to be notified promptly of the following:

- 1) A significant change in investment strategy and portfolio structure.
- 2) A material change in the ownership, personnel, financial condition, or investment approach of the organization.
- 3) Any changes in the regulatory environment that would affect the Plan or organization's role in its management.
- 4) Any litigation or violation of securities regulation in which the investment manager is involved.

The Plan has investments that represent 5% or more of the Plan's net position, which are as follows as of December 31, 2014:

Investment	Fair Value
Loomis Sayles Multi Sector Full Discretion Trust	\$ 6,687,874
2514 Select Portfolio Limited	4,329,871

The Plan's rated debt investments as of December 31, 2014, using the Moody's or S&P rating scale are presented below:

Investment Type	Moody's Rating	FMV	Total
Govt/agency obligations	*	\$ 216,964	
	Aaa	250,451	
	A2	306,965	
	Ba2	294,812	
	B2	287,650	
	Baa3	468,579	1,825,421
Municipal bonds	Aa2	519,805	519,805
Corporate bonds	Aaa	1,743,604	
	Aa2	5,346,888	
	Aa3	451,468	
	A2	73,567	
	A3	407,832	
	Baa1	371,849	
	Baa2	1,340,204	
	Baa3	1,401,013	

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

NOTE 3: *CASH AND INVESTMENTS – continued*

<u>Investment Type</u>	Moody's <u>Rating</u>	<u>FMV</u>	
Corporate bonds	Ba1	1,071,535	
	Ba2	280,891	
	Ba3	321,018	
	B1	265,123	
	B2	220,700	
	B3	113,694	
	Caa1	73,567	
	Caa2	26,751	
	Caa3	-	
		Not Rated	<u>2,335,980</u>
Foreign bonds	Aaa	523,199	
	Ba1	122,089	
	B+ (S&P)	517,500	
	B3	358,750	
	Baa1	392,000	
	Baa3	892,162	
	BB (S&P)	291,000	
	Not Rated	<u>258,943</u>	<u>3,355,643</u>
Money market funds	Aaa	<u>6,004,315</u>	
Total		<u>\$ 27,550,868</u>	

\* *Investments are obligations of or guaranteed by the U.S. government and do not require disclosure of credit quality ratings.*

*Concentration of Credit Risk* – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Plan's investment policy does not limit investments in any one issuer except that the investment portfolio shall be diversified in accordance with the Target Allocation stated below and within the limitations so noted. The Asset Mix Policy established by the Board of Trustees represents a long-term view (a full market cycle). As such, rapid and sudden market movements may cause the Fund's actual asset mix to fall outside the stated policy range. Any such divergence, however, should be short-term in nature and must be ratified by the Board of Trustees at the first regularly scheduled Board meeting following this occurrence.

<u>Asset Class</u>	<u>Allocation Range</u>	<u>Target Allocation</u>
Cash or Cash Equivalents	1% to 25%	7.31%
Bonds	10% to 30%	22.15%
U.S Equities	15% to 25%	32.74%
International Equities	15% to 25%	4.09%
Global Commercial Real Estate	5% to 20%	19.27%
Income producing real estate	Up to 10%	3.81%
Alternative Investments	5% to 15%	<u>10.63%</u>
		100.00%

*Foreign Currency Risk* – Foreign currency risk is the risk that changes in exchanged rates will adversely affect the fair value of an investment or deposit. All 2014 assets were priced in U.S. dollars.

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### NOTE 3: CASH AND INVESTMENTS – continued

*Commitments* – As of December 31, 2014, the Plan has no additional commitments to any fund manager.

*Rate of return* – For the year ended December 31, 2014, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 3.38%. The money-weighted rate of return expresses investment performance, net of plan investment expense, adjusted for the changing amounts actually invested.

### NOTE 4: NET PENSION LIABILITY

The components of the net pension liability of the Plan at December 31, 2014, were as follows:

Total pension liability	\$ 124,429,495
Plan fiduciary net position	82,552,420
Net pension liability	<u>\$ 41,877,075</u>
Plan fiduciary net position as a percentage of the total pension liability	66.34%

*Actuarial assumptions* – The total pension liability was determined by an actuarial valuation dated as of January 1, 2014, using the following actuarial assumptions, applied to all periods included in the measurement. Update procedures were used to roll forward the total pension liability from the actuarial valuation date to the pension plan's fiscal year-end.

Inflation	3.0%
Salary increases	4.5% per year, compounded annually
Investment rate of return	8.0%

Mortality rates were based on the RP-2000 Healthy Annuitant Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements projected to 2015 using Scale AA.

The actuarial assumptions used in the January 1, 2014 valuation were based on the results of an actuarial experience study for the period January 1, 2012 – December 31, 2013.

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 pension plan 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 January 1, 2014 are summarized in the following table:

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### NOTE 4: NET PENSION LIABILITY – continued

Asset Class	Long-Term Expected Real Rate of Return
<b>Cash &amp; short-term fixed income</b>	0.00%
<b>Fixed income</b>	
(a ) Investment Grade	3.00%
(b ) High Yield	5.00%
<b>Equities, Real Estate, and Alternative Investments</b>	
(a ) Large-cap	6.75%
(b ) Large-cap value	6.75%
(c ) Small-mid-cap	8.40%
(d ) Emerging Markets	6.00%
(e ) International Equities	5.80%
(f ) Real Estate	7.75%
(g ) Master limited partnership	9.00%
(h ) Hedge fund	6.75%

*Discount rate* – The discount rate used to measure the total pension liability was 8.00 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 pension plan's net position held in trust was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

*Sensitivity of the net pension liability to changes in the discount rate* – The following presents the net pension liability of the Plan at December 31, 2014, calculated using the discount rate of 8.00 percent, as well as what the Plan's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7.00 percent) or 1-percentage-point higher (9.00 percent) than the current rate:

	1% Decrease (7.00%)	Current Discount Rate (8.00%)	1% Increase (9.00%)
Plan's net pension liability	\$ 55,501,548	\$ 41,877,075	\$ 30,407,308

### NOTE 5: RISKS AND UNCERTAINTIES

The Plan invests in investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term and those changes could materially affect the amounts reported in the statement of fiduciary net position.

Plan contributions are made and the actuarial present value of accumulated plan benefits are reported based on certain assumptions pertaining to interest rates, inflation rates and employee demographics, all of which are subject to change. Due to uncertainties inherent in estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND**

Midland, Texas

NOTE 6: *ADMINISTRATION*

The financial affairs of the Plan are administered by a bank trust department, multiple investment managers engaged by the Plan's Board of Trustees, and a plan administrator employed by the Plan. Investments are held at a separate institution for safekeeping. The expense of such services, legal, actuarial and auditing costs are paid by the Plan.

**REQUIRED SUPPLEMENTARY INFORMATION**

**MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND**

Midland, Texas

**Schedule of Changes in Net Pension Liability and Related Ratios**

Discount Rate	8.00%
Annual Increase in Payroll	4.50%
Actuarial Valuation Date	1/1/2014
Measurement Date	<u>12/31/2014</u>
<b>Total Pension Liability</b>	
1. a. Service Cost (Pension benefits)	\$ 3,621,165
b. Service Cost (Administrative expenses)	222,705
2. Interest	9,442,123
3. Changes in Benefit Terms	-
4. Difference Between Expected and Actual Experience	-
5. Changes in Assumptions	-
6. Benefit Payments (including refunds of member contributions)	<u>(6,301,043)</u>
7. Net Change in Total Pension Liability	6,984,950
8. Total Pension Liability-Beginning of the Year	<u>117,444,545</u>
9. Total Pension Liability-End of the Year- December 31, 2014	\$ <u>124,429,495</u>
<b>Plan Fiduciary Net Position</b>	
10. Contributions - employer	\$ 3,318,107
11. Contributions - members	2,055,503
12. Net Investment Income	2,747,881
13. Benefit Payments (including refunds of member contributions)	(6,301,043)
14. Administrative Expenses	(222,705)
15. Other	<u>3,863</u>
16. Net Change in Plan Fiduciary Net Position	1,601,606
17. Plan Fiduciary Net Position-Beginning of the Year	<u>80,950,814</u>
18. Plan Fiduciary Net Position-End of the Year- December 31, 2014	\$ <u>82,552,420</u>
19. Net Pension Liability-End of the Year (line 9 minus line 18)	\$ 41,877,075
20. Plan Fiduciary Net Position as a Percentage of the Total Pension Liability-End of the Year	66.34%
21. Covered Employee Payroll	\$ 15,223,386
22. Net Pension Liability-End of the Year as a Percentage of Covered Employee Payroll	275.08%
23. Annual Money-weighted Rate of Return Net of Pension Plan Investment Expense with Inputs Determined At Least Monthly	3.38%
24. Actuarially Determined Contribution	3,318,107
25. Contributions in Relation to the Actuarially Determined Contribution	<u>3,318,107</u>
26. Contribution Deficiency (Excess)	-
27. Contribution as a Percentage of Covered-employee Payroll	21.80%

Note: In accordance with Par. 50 of GASB Statement No. 67, this schedule only includes information which has been measured in conformity with Statement No. 67. Disclosures for years in which information was not developed in accordance with GASB Statement No. 67 have not been included.

# MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

## NOTE TO REQUIRED SUPPLEMENTARY INFORMATION

The more significant assumptions underlying the actuarial computations are as follows:

Discount Rate	8.0% per annum, compounded annually										
Mortality	Employee and healthy annuitant combined rates from the RP-2000 Mortality Table, projected to 2015 using Scale AA, with separate rates for males and females										
Termination	Table T-1 from the <i>Actuary's Pension Handbook</i> . Specimen rates are: <table><thead><tr><th><u>Age</u></th><th><u>Termination Rate</u></th></tr></thead><tbody><tr><td>25</td><td>4.97%</td></tr><tr><td>35</td><td>2.49%</td></tr><tr><td>45</td><td>0.62%</td></tr><tr><td>55</td><td>0.00%</td></tr></tbody></table>	<u>Age</u>	<u>Termination Rate</u>	25	4.97%	35	2.49%	45	0.62%	55	0.00%
<u>Age</u>	<u>Termination Rate</u>										
25	4.97%										
35	2.49%										
45	0.62%										
55	0.00%										
Disability	Rates developed from the 1985 Society of Actuaries Disability Table Study using Class 1 male rates with 90-day elimination period. Specimen rates are: <table><thead><tr><th><u>Age</u></th><th><u>Disability Rate</u></th></tr></thead><tbody><tr><td>25</td><td>0.187%</td></tr><tr><td>35</td><td>0.164%</td></tr><tr><td>45</td><td>0.335%</td></tr><tr><td>55</td><td>0.858%</td></tr></tbody></table>	<u>Age</u>	<u>Disability Rate</u>	25	0.187%	35	0.164%	45	0.335%	55	0.858%
<u>Age</u>	<u>Disability Rate</u>										
25	0.187%										
35	0.164%										
45	0.335%										
55	0.858%										
Assumed retirement age for active members	Retirement rates are as shown in RR Table 0613.										
Assumed retirement age for vested terminated members	Benefits for vested terminated members are assumed to start on the date the member attains age 50 or, if later, the date the member would have completed 20 years of service.										
Increases in total payroll	4.50% per year, compounded annually										
Marital status											
a. Proportion married	Males: 90%, Females: 90%										
b. Differences in age	Actual age differences are used for married members. Ninety percent of unmarried members are assumed to be married at retirement. Males are assumed to be three years older than their spouses.										

# MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

## NOTE TO REQUIRED SUPPLEMENTARY INFORMATION

The more significant assumptions underlying the actuarial computations are as follows: (continued)

Assumed form of payment	Members eligible for the Option 3 (Retroactive DROP) are assumed to elect either the straight service retirement benefit or the Option 3 (Retroactive DROP), whichever is more valuable. Other members are assumed to receive straight service retirement benefits.
Assumed death benefit to Children	Each member is assumed to have two children. The first child is assumed to have been born when the member was age 25. The second child is assumed to be two years younger. It is also assumed that benefits will be paid until each child reaches the age of 22.
Assumed Contribution Rates:	
a. Members	13.20% of compensation
b. City contribution	21.70% of compensation

Decrements are assumed to be annual rates, rather than probabilities, and are adjusted for the interaction between competing decrements. The 8.00 percent rate of return was set by examining the Fund's rate of return history and by taking into account future expected rates of return for portfolios with similar asset allocations. The assumed 8.00 percent rate can be considered to include a provision for inflation at 3.00 percent per year, although other combinations of real return, risk premium and inflation are also accounted for by an 8.00 assumed rate. The rate of return is net of trust expenses. The same inflation component was used in the assumed rate of return on the actuarial value of assets, the assumed increases in compensation for individual members and the other actuarial assumptions.

The plan does not provide for an increase in retiree benefits unless the fund's rolling five-year average rate of return is at least 8.25 percent per year as of the valuation date. The rolling five-year average rate of return for the five year period ending December 31, 2013, was greater than 8.25 percent per year. For this reason, the plan provided a benefit increase to inactive retirees as of August 1, 2014. The rate of return assumed for purposes of valuing the plan is 8.00 percent per annum. If the plan's rate of return in future years equals the assumed rate of return, no future retiree increases will be granted because the requirement for such increases will never be met. However, variations in the rate of return from year to year can produce a five-year average which is at least 8.25 percent even when longer-term averages are lower than the prescribed rate. Retiree increases after 2014 were not included in the valuation. Such increases will be valued if experience shows that such an assumption is warranted.

The valuation includes provisions for mortality improvement to 2015. The mortality table used in the valuation is updated periodically. The actuaries are not aware of any significant event that has occurred since the valuation date that would have materially changed any of the demographic assumptions selected for the valuation.

## MIDLAND FIREMEN'S RELIEF AND RETIREMENT FUND

Midland, Texas

### Changes in Actuarial Assumptions

The salary scale table was changed by setting back each salary increase rate in the table used for the 2014 valuation by one year of service. The assumed contribution rate was increased to 21.70 percent of pay, the rate at which the City of Midland began contributing October 1, 2014. The changes were made in order to most accurately reflect anticipated plan experience.