

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

**FINANCIAL STATEMENTS
AND SUPPLEMENTAL SCHEDULES**

**Year Ended December 31, 2016
with Report of Independent Auditors**

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

**FINANCIAL STATEMENTS
AND SUPPLEMENTAL SCHEDULES**

Year Ended December 31, 2016

Table of Contents

Report of Independent Auditors	1
Management's Discussion and Analysis (Unaudited)	3
Basic Financial Statements	
Statement of Fiduciary Net Position	6
Statement of Changes in Fiduciary Net Position	7
Notes to the Financial Statements	8
Required Supplementary Information (Unaudited)	
Schedule of Changes in Net Pension Liability and Related Ratios	20
Schedule of Contributions	21
Notes to the Schedule of Contributions	22

REPORT OF INDEPENDENT AUDITORS

To the Board of Trustees
City of Galveston Employees' Retirement
Plan for City Employees

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Galveston Employees' Retirement Plan for City Employees (the "Plan"), a component unit of the City of Galveston, which comprise the statement of net position as of December 31, 2016, and the related statement of changes in 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 fraud or error.

Auditors' 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 Plan'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 Plan'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.

To the Board of Trustees
City of Galveston Employees' Retirement
Plan for City Employees

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Plan, as of December 31, 2016, and the changes 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 the management's discussion and analysis and required supplementary pension information on pages 3 and 4 and 20 through 23 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.

Whitley Penn LLP

Houston, Texas
August 1, 2017

**CITY OF GALVESTON EMPLOYEES’
RETIREMENT PLAN FOR CITY EMPLOYEES**

MANAGEMENT’S DISCUSSION AND ANALYSIS (UNAUDITED)

This section of the City of Galveston Employees’ Retirement Plan for City Employees (the “Plan”) provides an overall review of the Plan’s financial activities for the year ended December 31, 2016. Readers should consider the information here in conjunction with the financial statements, notes to the financial statements and required supplementary information, in order to enhance their understanding of the Plan’s financial performance.

Financial Statements

The Statement of Fiduciary Net Position presents the Plan’s assets and liabilities and the resulting net position, which are held in trust for retirement benefits. This statement reflects a year-end snapshot of the Plan’s investments, at fair value, along with cash and short-term investments, receivables and other assets and liabilities. The Statement of Changes in Fiduciary Net Position, on the other hand, provides a view of current year additions to and deductions from the Plan. The Plan is a single employer defined benefit pension plan. The Plan is a component unit of the City of Galveston, Texas (the “City”), and, as such, its reports are included in the Fiduciary Funds of the City as restricted assets.

Financial Highlights

The Plan presents its financials solely on the accounts of the Plan. The accrual basis of accounting is used by the Plan, whereby revenues are recognized when they are earned and collection is reasonably assured, and expenses are recognized when the liability has been incurred. Investments are reported at fair value.

A summary of the Statement of Fiduciary Net Position for the Plan is as follows (in 000’s):

	2016	2015	Change	
			\$	%
Assets				
Investments, at fair value	\$ 45,640	\$ 42,900	\$ 2,740	6%
Other assets	26	68	(42)	-62%
Total Assets	45,666	42,968	2,698	6%
Liabilities				
Accounts payable	26	26	-	0%
Net position - restricted for pension benefits	\$ 45,640	\$ 42,942	\$ 2,698	6%

The Plan’s net position increased by \$2.7 million, or 6%, in 2016. This was primarily due to an increase in investments due to an improvement in the market.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) (continued)

A summary of the Statement of Changes in Fiduciary Net Position is as follows (in 000's):

	<u>2016</u>	<u>2015</u>	<u>Change</u>	
			<u>\$</u>	<u>%</u>
Additions				
Total contributions	\$ 3,431	\$ 3,284	\$ 147	4%
Net investment income	3,334	(857)	4,191	489%
Total Additions	<u>6,765</u>	<u>2,427</u>	<u>4,338</u>	<u>179%</u>
Deductions				
Benefits	3,922	4,103	(181)	-4%
Administrative expenses	145	127	18	14%
Total Deductions	<u>4,067</u>	<u>4,230</u>	<u>(163)</u>	<u>-4%</u>
Change in net position	2,698	(1,803)	4,501	-250%
Net position - restricted for pension benefits, Beginning of the year	<u>42,942</u>	<u>44,745</u>	<u>(1,803)</u>	<u>-4%</u>
Net position - restricted for pension benefits, End of the year	<u>\$ 45,640</u>	<u>\$ 42,942</u>	<u>\$ 2,698</u>	<u>6%</u>

Net investment income increased by 489% in 2016. During the third quarter of 2015, the stock market experienced a significant drop and market values decreased significantly and caused an overall loss for the year in 2015. The outlook improved in 2016 and led to a gain on investments.

Next Year's Rates

The 2016 plan contribution rates for the City and Employees are 9% and 6% respectively. This represents no change from 2015.

Contacting the Plan's Financial Management

This financial report is designed to provide members and other users with a general overview of the Plan's finances and to show the Plan's accountability for the funds it receives. If you have questions about this report, you may contact the Plan's Administrator at 1011 Tremont, Galveston, TX 77550 or by phone at 409-765-9311.

BASIC FINANCIAL STATEMENTS

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES
STATEMENT OF FIDUCIARY NET POSITION**

	<u>December 31, 2016</u>
Assets	
Investments at fair value:	
Money market funds	\$ 1,169,969
Domestic equity mutual Funds	23,072,032
International equity mutual funds	3,232,390
Fixed income mutual funds	13,523,184
Balanced equity mutual funds	<u>4,642,517</u>
Total Investments at fair value	45,640,092
Receivables:	
Accrued interest and dividends	<u>25,934</u>
Total Assets	<u>45,666,026</u>
Liabilities	
Accounts payable	<u>25,832</u>
Net position - restricted for pension benefits	<u><u>\$ 45,640,194</u></u>

See accompanying notes to the financial statements.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

STATEMENT OF CHANGES IN FIDUCIARY NET POSITION

	Year Ended December 31, 2016
Additions	
Contributions:	
Employer	\$ 2,059,527
Employees	1,371,184
Total contributions	3,430,711
Investment income:	
Net appreciation of investments	2,526,242
Dividends	947,654
Less investment expenses	(140,066)
Net investment income	3,333,830
Total additions	6,764,541
Deductions	
Benefits:	
Retirement	3,398,257
Survivor	317,663
Disability	32,718
Rollover	169,657
Employee contribution refunds	3,264
Administrative expenses	145,136
Total deductions	4,066,695
Change in net position	2,697,846
Net position restricted for pension benefits	
Net position - beginning	42,942,348
Net position - ending	\$ 45,640,194

See accompanying notes to the financial statements.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2016

A. Description of the Plan

The City of Galveston Employees' Retirement Plan for City Employees (the "Plan"), a component unit of the City of Galveston (the "City"), is a single-employer defined benefit pension plan created by City ordinance under the authority of Title 8, Subchapter A of the Texas Government Code, to provide retirement and incidental benefits for employees of the City who are not Participants of the retirement plans for the police department employees or firefighters. The Plan has been designed as a "governmental plan" by the U.S. Department of Labor and, thus, is not subject to the provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA).

Effective January 1, 2009, the Plan was amended and restated to allow employees to repurchase years of service under the Plan. Members wishing to repurchase years of service must deposit the present value of the increase in the present value of the member's accrued benefit in the Plan. The amendment also included modifications to the requirements for the payout of lump sum amounts, so that no consent is required for amounts less than \$1,000. The following brief description of the Plan, as amended and restated, is provided for general information purposes only. Participants should refer to the Plan agreement for more complete details.

The City of Galveston, Texas, is the Plan sponsor. All active employees of the City are Participants of the Plan except for part-time employees, temporary employees performing emergency service, employees compensated on a fee basis, employees who are Participants of the City of Galveston Employees' Retirement Plan for Police, employees who are Participants of the Galveston Firefighters' Pension Fund and leased employees. Participation is mandatory for all employees hired after January 1, 1957.

Plan Administration

A Plan Administrator appointed by a seven-Participant Board of Trustees administers the Plan. Some of the more significant responsibilities of the Plan Administrator are:

- to construe and interpret the Plan, decide all questions of eligibility and determine the amount, manner and time of payment of any benefits under the Plan;
- to receive from the City and from Participants such information as shall be necessary for the proper administration of the Plan;
- to receive and review the periodic valuation of the Plan made by the Plan's actuary;
- to receive and review reports of the financial condition and of the receipts and disbursements of the Trust Fund from the Trustee;
- to appoint or employ for the Plan any agent he deems advisable, including, but not limited to, legal counsel, accountants, consultants and actuaries;
- to adopt such rules and regulations for the administration of the Plan as he deems necessary or desirable, with such rules and regulations being subject to review by the Board.

Contributions

The City and Employees currently contribute 9 percent and 6 percent, respectively of covered compensation to the pension plan.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

A. Description of the Plan - continued

Retirement Benefits

Plan Participants are eligible for normal retirement at age 65. Normal retirement date is the last day of the month in which a Participant reaches his 65th birthday and completes five years of vesting service. Payments commence on the first day of the following month. The normal retirement benefit under the Plan equals the greater of 2.25% of Average Monthly Compensation on December 31, 2003, multiplied by a Participant's years of benefit service on December 31, 2003, or 2.25% of Average Monthly Compensation multiplied by a Participant's years of benefit service. The maximum normal retirement benefit is \$4,167 per month. Service retirement benefits are payable for the Participant's lifetime. In the event the Participant's death precedes that of his or her spouse, one half of the Participant's pension will be continued to the spouse for his or her lifetime or until remarried.

The Plan permits early retirement after age fifty-five (55) and ten years of vesting service or after age sixty-two (62) and five years of vesting service. If a Participant chooses to receive this benefit on or after early retirement, the Participant receives a benefit equal to the normal retirement benefit multiplied by the Participant's years of Benefit Service as of his early retirement date. If the Participant's pension commences prior to his normal retirement date, the foregoing monthly benefit is reduced by 1/180th for each of the first sixty (60) months and 1/360th for each of the next sixty (60) months preceding age sixty-five (65) calculated from the starting date of the payments. This reduction does not apply to Participants who have completed 20 or more years of vesting service as of December 31, 2003; Participants who completed fifteen years of vesting service as of December 31, 2003, and twenty years of vesting service at date of termination; or individuals who were Participants on June 1, 1994, were hired after the age of 45 and who have completed 10 years of vesting service. Early retirement benefits are payable for the Participant's lifetime. In the event the Participant's death precedes that of his or her spouse, one-half of the Participant's pension will be continued to the spouse for his or her lifetime or until remarried.

An active Participant of the Plan who neither has a right to a Deferred Vested Pension under the Plan nor is drawing a monthly Pension from the Plan may repurchase the period or periods of prior Service he or she served under this Plan. The amount which the Participant must deposit into the fund shall equal the present value, on the date of repayment, of the increase in the present value of the Participant's Accrued Benefit under the Plan which results from the Participant's repurchased service. A Participant who requests the calculation of the amount needed to repurchase prior Service shall bear the cost of the calculation, regardless of whether the Participant actually chooses to make such repurchase. The repayment of Participant contributions shall be deemed an after-tax contribution under the Plan.

A Participant shall be eligible for a deferred vested pension if his employment is terminated for reasons other than death, disability or any of the aforementioned retirement provisions on or after five (5) or more years of service and prior to age sixty-five (65). Payment of the deferred vested pension is to commence at age sixty-five (65). If the Participant has completed at least ten (10) years of service, the deferred vested pension may commence at age fifty-five (55).

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

A. Description of the Plan - continued

Retirement Benefits - continued

A Participant who meets the requirements for a deferred vested pension shall receive a non-forfeitable right to the accrued pension benefit payable monthly in accordance with the following schedule:

Years of Vesting Service	Percentage %
Less than 5	0%
5	50%
6	60%
7	70%
8	80%
9	90%
10	100%

If the payment commences prior to age sixty-five (65), the amount determined above shall be reduced by 1/180th for each of the first sixty (60) months and 1/360th for each additional month by which the starting date of pension payment precedes age sixty-five (65).

Optional Forms of Benefits

A Participant who takes normal or early retirement or receives a vested termination benefit under the Plan may elect to receive a lump sum distribution of his or her accumulated contributions and a reduced monthly benefit. If the single sum value of a Participant's benefit is less than \$15,000, the Participant may elect to receive the entire value of his or her accrued benefit paid in a lump sum.

Severance Benefits

The minimum severance benefit is a refund of the Participant's accumulated contributions. After becoming eligible to receive benefits, a retired Participant may elect to receive a refund of his contribution accumulation, if any. Such election must be made prior to the commencement of any benefit payments and the Participant forfeits any further rights or benefits under the Plan. Payments of a Participant's contribution accumulation and other single-sum benefits shall be paid in one lump sum or in installments without interest accruing thereon.

Disability Benefits

A Participant, regardless of the Participant's age and years of service, terminated by reason of total and permanent disability, is eligible for a monthly pension, payable until death or when the disability ceases, whichever occurs earlier, commencing upon the latter of certification of the disability or 90 days after date of disability. The pension amount prior to age sixty-five (65) is calculated at 60% of the Participant's monthly rate of pay at the time of the disability, reduced by any workers' compensation, Railroad Retirement or any other disability plan payments, excluding primary social security disability. The pension amount will not exceed One Thousand Five Hundred Dollars (\$1,500) per month. On and after age sixty-five (65), the pension amount is calculated as for normal retirement benefits assuming a constant rate of pay and service from disability to age sixty-five (65).

**CITY OF GALVESTON EMPLOYEES’
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

A. Description of the Plan - continued

Death Benefits

The minimum in-service death benefit after completing five (5) years of service will be Two Thousand Five Hundred Dollars (\$2,500) or the Participant's contribution accumulation, whichever is greater, less any payments paid to or on behalf of the deceased.

The Plan provides for a monthly pension for a surviving spouse or dependent children, if the Participant should die while actively employed and has completed five (5) or more years of service. The monthly benefit, commencing on the first day of the month after the date of death, payable for life or until remarriage, whichever occurs earlier, is equal to fifty percent (50%) of the normal retirement benefits considering average compensation and service at date of death. In the event of surviving children and no surviving spouse, or surviving dependent children upon the death of the surviving spouse, each dependent child is eligible for a monthly pension, payable until the attainment of age eighteen (18) or until such child's death prior to attaining age eighteen (18). If there is more than one child under the age eighteen (18), then such benefit is divided proportionately among those children under age eighteen (18) at the time of Participant's death.

Participation Summary Data

Below is a summary of the participant data for the Plan as of December 31, 2016, the date of the Plan's last actuarial valuation:

Retirees and beneficiaries currently receiving benefits	334
Inactive employees entitled to only a refund of contributions	175
Inactive employees entitled to but not receiving benefits	57
Active employees	510
Total Participants	<u><u>1,076</u></u>

B. Summary of Significant Accounting Policies

Basis of Accounting

The Plan's financial statements are prepared using the accrual basis of accounting.

Contributions

Plan Participant contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions.

Benefit payments

Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

B. Summary of Significant Accounting Policies - continued

Use of Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value

Plan investments are presented at fair value or estimated fair value. Fair value measurements are based on the hierarchy established by generally accepted accounting principles.

Administrative Expenses

The Plan pays all administrative expenses incurred in the administration of the Plan, including expenses and fees of the trustee. All fees are paid from the trust fund. Expenses are recorded when incurred.

Refunds Paid

Participants are eligible for a refund of their contributions upon termination of service. No interest is paid on refunds. Terminated employees must request a refund of contributions. Contribution refunds are recorded when paid.

New Accounting Standards

In the current year, the Plan implemented the following new standards. The applicable provisions of these new standards are summarized below. Implementation is reflected in the financial statements and the notes to the financial statements.

GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, clarifies the application of certain provisions of Statement No. 68 with regard to information that is required to be presented as notes to the 10-year schedules of required supplementary information about investment-related factors that significantly affect trends in the amounts reported.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

C. Cash, Investments and Related Activity

Cash and Cash Equivalents

The Plan considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents consist of money market funds. Cash balances were covered by federal depository insurance and/or by collateral held by the Plan's agent in the Plan's name.

Investments

The Plan's investment policy provides for investments in fixed income securities and equities. Statutes of the State of Texas authorize the Plan to invest surplus funds in a manner provided by the Government Code, Chapter 802, Subchapter C.

Investments are reported at fair value. Fair value measurements are based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; level 3 inputs are significant unobservable inputs.

The Plan's investments at fair value measurements are as follows at December 31, 2016:

<u>Plan Asset</u>	<u>Level 1 Inputs</u>	<u>Level 2 Inputs</u>	<u>Level 3 Inputs</u>	<u>Percentage of Total</u>
Money Market Mutual Fund	\$	\$ 1,169,969	\$	3%
Mutual Funds		44,470,123		97%
	<u>\$</u>	<u>\$ 45,640,092</u>	<u>\$</u>	<u>100%</u>

Realized Gains and Losses

During 2016, the Plan realized a net gain of \$556,638 from the sale of investments. The calculation of realized gains and losses is independent of the calculation of the net increase or decrease in the fair value of investments. Realized gains and losses on investments that have been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net increase in the fair value of investments during 2016 was \$2,526,242. This amount takes into account all changes in fair value that occurred during the year. The unrealized gain on investments held at year-end was \$1,855,795.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

C. Cash, Investments and Related Activity - continued

Investments - continued

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Plan will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Plan, and are held by either the counterparty or the counterparty's trust department or agent but not in the Plan's name. At December 31, 2016, the Plan's investments that were not subject to custodial credit risk were the investments in corporate and foreign bonds and common equity and preferred stock securities as they are registered in the name of the Plan and held by the agent.

Concentration of Credit Risk

The allocations of assets among various asset classes are set by the board. The Plan will contract with investment managers to use different investment approaches but maintain a balanced portfolio. Statutes of the State of Texas authorize the Plan to invest surplus funds in a manner provided by the Government Code, Chapter 802, Subchapter C. The Plan provides that no more than 10% of the Plan's market value will be invested in any one common equity security and no more than 30% of the market value will be invested in any one industry.

The following was the Board's adopted asset allocation policy as of December 31, 2016:

<u>Asset Class</u>	<u>Minimum</u>	<u>Maximum</u>
Equities	25%	70%
Fixed Income	25%	60%
Alternatives	0%	30%
Cash	1%	50%

The plan's assets are allocated in the following manner at December 31, 2016:

<u>Plan Asset</u>	<u>Fair Value</u>	<u>Percentage of Total Portfolio</u>
Money market funds	\$ 1,169,969	3%
Domestic equity mutual Funds	23,072,032	50%
International equity mutual funds	3,232,390	7%
Fixed income mutual funds	13,523,184	30%
Balanced equity mutual funds	4,642,517	10%
	<u>\$ 45,640,092</u>	<u>100%</u>

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

C. Cash, Investments and Related Activity - continued

Investments - continued

Rate of Return

For the year ended December 31, 2016, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 7.82% percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Interest Rate Risk

The Plan's investment policy does not address interest rate risk beyond the applicable investments above as defined by state statutes and provisions. Information about the exposure of the Plan's debt type investments to this risk, using the segmented time distribution model is as follows:

The Plan's portfolio at December 31, 2016, is allocated in the following manner:

Investment Type	Investment Maturities (in Years)			
	Fair Value	Less than 1	6-10	>10
Money Market Mutual Fund	1,169,969	\$ 1,169,969	\$ -	\$ -
Fixed income mutual funds	13,523,183	-	11,680,042	1,843,141
	<u>\$ 14,693,152</u>	<u>\$ 1,169,969</u>	<u>\$ 11,680,042</u>	<u>\$ 1,843,141</u>

Credit Risk

Generally, credit risk is the risk that an issuer of a debt-type investment will not fulfill its obligations to the holder of the investment. This is measured by assignment of a rating by a nationally-recognized rating organization. The Plan's investment policy allows for investment in bonds rated BBB (or equivalent) or better. Below investment grade allocation in excess of 25% of the aggregate fixed income portfolio must have approval from the Board. The Plan's debt investments' ratings at December 31, 2016, are presented below:

Rated Debt Investments	Quality Ratings			
	Fair Value	AAA	BBB	Unrated
Money Market Mutual Fund	1,169,969	\$ 1,169,969	\$ -	\$ -
Fixed income mutual funds	13,523,183	-	11,236,767	2,286,416
	<u>\$ 14,693,152</u>	<u>\$ 1,169,969</u>	<u>\$ 11,236,767</u>	<u>\$ 2,286,416</u>

D. Net Pension Liability

The components of the net pension liability of the plan at December 31, 2016 were as follows:

Total pension liability	\$ 61,089,640
Plan fiduciary net position	(45,640,194)
Plan net pension liability	<u>\$ 15,449,446</u>

Plan fiduciary net position as a percentage of the total pension liability	74.71%
----------------------------------------------------------------------------	--------

**CITY OF GALVESTON EMPLOYEES’
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

D. Net Pension Liability - continued

Actuarial Assumptions

The total pension liability was determined by an actuarial valuation as of December 31, 2016 using the following actuarial assumptions:

Investment rate of return	7.25%	net of pension plan investment expense, including inflation
Inflation	3.00%	
Annual pay increases	3.00%	per year, plus promotion, step and longevity increases that vary by service

The mortality rates were based RP-2000 Combined Healthy Mortality Tables for males and for females (sex distinct), projected to 2024 using Scale AA.

Long Term Expected Rate of Return

The long-term expected rate of return on pension plan investments is reviewed for each annual actuarial valuation and was determined using a building-block method in which expected future net real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These components are combined to produce the long-term expected rate of return by weighting the expected future net real rates of return by the current asset allocation percentage (currently resulting in 4.47%) and by adding expected inflation (3%). In addition, the final 7.25% assumption was selected by “rounding down” and thereby reflects a reduction of 0.22% for adverse deviation. The current allocation and expected arithmetic net real rates of return for each major asset class are summarized in the following table:

Asset Class	Current Allocation	Long-Term Expected Net Real Rate of Return
Equities		
Large cap domestic	27.3%	6.19%
Mid cap domestic	14.4	6.70
Small cap domestic	8.9	6.71
International developed	7.9	6.09
Fixed income		
Core	20.6	1.35
Global	4.1	1.72
Multisector	5.0	1.83
Alternatives	10.2	2.87
Cash	<u>1.6</u>	0.18
Total	100.0%	
Weighted Average		4.47%

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

D. Net Pension Liability - continued

Discount Rate

The discount rate used to measure the total pension liability was 7.25%. No projection of cash flows was used to determine the discount rate because the December 31, 2016 actuarial valuation showed that expected contributions would pay the normal cost and amortize the unfunded actuarial accrued liability (UAAL) in 13 years. That actuarial valuation report also said that if the plan fiduciary net position as of December 31, 2016 had been used in place of the actuarial value of assets, then the UAAL amortization period would have been 17 years. Because of the 17-year amortization period of the UAAL with the lower value of assets, the pension plan's fiduciary net position is expected to be available to make all projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments of 7.25% was applied to all periods of projected benefit payments as the discount rate to determine the total pension liability.

Sensitivity of 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 7.25% as well as what the City's net pension liability would be if it were to be calculated using the discount rate that is 1 percentage-point lower (6.25%) or 1 percentage-point higher (8.25%) than the current rate:

	1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
Net pension liability	\$ 22,175,276	\$ 15,449,446	\$ 9,725,052

E. Tax Status

The Plan obtained its latest determination letter dated June 9, 2011, in which the Internal Revenue Service stated that the Plan, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code Section 401(a) and that, therefore, the Plan is tax-exempt.

F. Plan Termination

Although the Board has not expressed any intent to terminate the Plan, upon complete or partial termination of the Plan, each affected Member's accrued benefit, based on his years of Service and Average Monthly Compensation prior to that date of such termination, shall become fully vested and non-forfeitable to the extent then funded.

**CITY OF GALVESTON EMPLOYEES’
RETIREMENT PLAN FOR CITY EMPLOYEES**

NOTES TO THE FINANCIAL STATEMENTS (continued)

G. Risks and Uncertainties

The Plan invests in various 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 the value of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits.

H. Commitments and Contingencies

As described in Note A, eligible participants are entitled to payment of their accumulated contributions upon termination. As of December 31, 2016, aggregate contributions were approximately \$11.1 million.

I. Administrative Expenses

Administrative expenses are paid from Plan assets and were comprised of the following for the year ended December 31, 2016:

	<u>2016</u>
Actuarial services	\$ 54,580
Legal fees	14,208
Accounting and consulting fees	74,154
Other	2,194
	<u><u>\$ 145,136</u></u>

**REQUIRED SUPPLEMENTARY INFORMATION
(UNAUDITED)**

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR EMPLOYEES**

REQUIRED SUPPLEMENTARY INFORMATION

**Schedule of Changes in the City of Galveston's Employees' Retirement Plan for Employees
Net Pension Liability and Related Ratios
Last Three Measurement Years**

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Total pension liability			
Service costs (Pension benefits)	\$ 1,782,456	\$ 2,036,695	\$ 2,184,793
Interest on pension liability	4,388,324	4,465,817	4,291,727
Changes of benefit terms			
Differences between expected and actual experience	(1,388,765)	(932,848)	-
Changes of assumptions	1,539,868	1,385,114	-
Benefit payments, including refunds of member contributions	<u>(3,921,559)</u>	<u>(4,102,964)</u>	<u>(3,820,447)</u>
Net change in total pension liability	2,400,324	2,851,814	2,656,073
Total pension liability - beginning	58,689,316	55,837,502	53,181,429
Total pension liability - ending {a}	<u>\$ 61,089,640</u>	<u>\$ 58,689,316</u>	<u>\$ 55,837,502</u>
Plan fiduciary net position			
Contributions - employer	\$ 2,059,527	\$ 1,968,772	\$ 1,836,025
Contributions - member	1,371,184	1,315,516	1,224,018
Net investment income	3,333,830	(856,751)	1,803,409
Benefit payments, including refunds of member contributions	(3,921,559)	(4,102,964)	(3,820,447)
Administrative expenses	<u>(145,136)</u>	<u>(127,457)</u>	<u>(123,414)</u>
Net change in plan fiduciary net position	2,697,846	(1,802,884)	919,591
Plan fiduciary net position - beginning	42,942,348	44,745,232	43,825,641
Plan fiduciary net position - ending {b}	<u>\$ 45,640,194</u>	<u>\$ 42,942,348</u>	<u>\$ 44,745,232</u>
Net pension liability - ending {a} - {b}	<u>\$ 15,449,446</u>	<u>\$ 15,746,968</u>	<u>\$ 11,092,270</u>
Fiduciary net position as a percentage of the total pension liability	74.7%	73.2%	80.1%
Covered employee payroll	\$ 22,853,067	\$ 21,925,267	\$ 20,400,300
Fund's net pension liability as a percentage of covered employee payroll	67.6%	71.8%	54.4%
Annual Money Weighted Net Rate of Return	7.82%	-1.94%	4.16%

Note to Schedule: Covered-employee payroll is estimated using employee contributions divided by the contribution percentage.

Note: GASB 67 was implemented in fiscal year 2014, therefore information for entire ten years is not available.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR EMPLOYEES**

REQUIRED SUPPLEMENTARY INFORMATION

**Schedule of the City of Galveston's Contributions
Last 10 Calendar Years**

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Actuarially determined employer contribution	\$ 2,056,776	\$ 1,728,814	\$ 2,040,170	\$ 2,108,505	\$ 2,026,248
Contributions in relation to the actuarially required contribution	<u>2,059,527</u>	<u>1,968,772</u>	<u>1,836,025</u>	<u>1,583,356</u>	<u>1,616,976</u>
Contribution deficiency (excess)	<u>\$ (2,751)</u>	<u>\$ (239,958)</u>	<u>\$ 204,145</u>	<u>\$ 525,149</u>	<u>\$ 409,272</u>
Covered-employee payroll	\$ 22,853,067	\$ 21,875,244	\$ 20,400,278	\$ 17,592,844	\$ 17,966,400
Contributions as a percentage of covered-employee payroll	9.0%	9.0%	9.0%	9.0%	9.0%
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Actuarially required contribution	\$ 1,786,959	\$ 1,772,588	\$ 1,909,866	\$ 1,514,397	\$ 1,502,821
Contributions in relation to the actuarially required contribution	<u>1,645,622</u>	<u>1,713,543</u>	<u>1,532,371</u>	<u>1,261,150</u>	<u>1,099,108</u>
Contribution deficiency (excess)	<u>\$ 141,337</u>	<u>\$ 59,045</u>	<u>\$ 377,495</u>	<u>\$ 253,247</u>	<u>\$ 403,713</u>
Covered-employee payroll	\$ 18,284,689	\$ 18,171,916	\$ 17,331,890	\$ 16,604,915	\$ 15,784,874
Contributions as a percentage of covered-employee payroll	9.0%	9.4%	8.8%	7.6%	7.0%

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR EMPLOYEES**

REQUIRED SUPPLEMENTARY INFORMATION

**Notes to Schedule of Contributions
Last Three Calendar Years**

Valuation date:	December 31, 2016	December 31, 2015
Methods and assumptions used to determine contribution rates:		
Asset valuation method	Fair Value	Fair Value
Actuarial cost method	Entry Age	Entry Age
Amortization method	Level percentage of payroll, open	Level percentage of payroll, open
Inflation	3.00%	3.25%
Investment rate of return	7.25%	7.50%
Administrative expense		
Salary increases	3.00% plus promotion, step and longevity increases that vary by service	3.25% plus promotion, step and longevity increases that vary by service
Mortality Rates:	Mortality rates were based on the RP-2000 Combined Healthy Mortality Tables for males and for females (sex distinct) projected to 2024 by scale AA.	Mortality rates were based on the RP-2000 Combined Healthy Mortality Tables for males and for females (sex distinct) projected to 2024 by scale AA.
Retirement Rates	Early retirement is allowed for employees who terminate (a) at age 55 to 64 with at least 10 years of service or (b) at age 62 to 64 with at least five years of service. A retirement benefit that commences before age 65 is reduced by a formula that approximates actuarially equivalent reduction.	Early retirement is allowed for employees who terminate (a) at age 55 to 64 with at least 10 years of service or (b) at age 62 to 64 with at least five years of service. A retirement benefit that commences before age 65 is reduced by a formula that approximates actuarially equivalent reduction.

**CITY OF GALVESTON EMPLOYEES'
RETIREMENT PLAN FOR EMPLOYEES**

REQUIRED SUPPLEMENTARY INFORMATION

**Notes to Schedule of Contributions
Last Three Calendar Years**

Valuation date:	January 1, 2015
Methods and assumptions used to determine contribution rates:	
Asset valuation method	Fair Value
Actuarial cost method	Entry Age Service Actuarial Cost Method
Amortization method	Level percentage of payroll, closed.
Inflation	3.00%
Investment rate of return	8.00%
Administrative expense	Assumed to increase 4.0% per year.
Salary increases	5.25% per year, compounded annually
Mortality Rates:	Employee and healthy annuitant combined rates from the RP-2000 Mortality Table, projected to 2015 using Scale AA, with the separate rates for males and females.
Retirement Rates	Active members are assumed to retire once they have both attained age 65 and completed at least 5 years of service. Active members who have already reached their assumed retirement age are assumed to retire on the valuation date.