

Firemen's Relief and Retirement Fund
A Fiduciary Fund of the City of McAllen, Texas

Financial Statements and Required
Supplementary Information
And Independent Auditor's Report

September 30, 2017

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of McAllen, Texas
September 30, 2017
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Independent Auditor's Report

To the Pension Board of Trustees
Firemen's Relief and Retirement Fund

Report on the Financial Statements

We have audited the accompanying financial statements of the Firemen's Relief and Retirement Fund (the Plan), a fiduciary fund of the City of McAllen, Texas, which comprise the statement of fiduciary net position as of September 30, 2017, the related statement of changes in fiduciary net position for the year then ended and 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.

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Plan, a fiduciary fund of the City of McAllen, Texas, as of September 30, 2017, and the changes in its fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements present only the financial position of the Firemen's Relief and Retirement Fund, a fiduciary fund of the City of McAllen, Texas, and do not purport to, and do not, present the financial position of the City of McAllen, Texas, as of September 30, 2017, and the changes in financial position for the year then ended.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Changes in Employer Net Pension Liability and Related Ratios, Schedule of Investment Returns, Schedule of Employer Contributions and Notes to the Required Supplementary Information, as listed in the table of contents, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 27, 2018, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Plan's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Plan's internal control over financial reporting and compliance.

RSM US LLP

San Antonio, Texas
February 27, 2018

MANAGEMENT’S DISCUSSION AND ANALYSIS

The following is management’s discussion and analysis of the financial performance of the Firemen’s Relief and Retirement Fund (the “Plan”) of McAllen, Texas. It is presented as a narrative overview and analysis for the purpose of assisting the reader with interpreting key elements of the financial statements, notes to the financial statements, and required supplementary information.

OVERVIEW OF THE FINANCIAL STATEMENTS

Management’s discussion and analysis is intended to serve as an introduction to the Plan basic financial statements, together with the related notes to the financial statements, required supplementary information, and the supporting schedules, all of which are described below:

Fund Financial Statements:

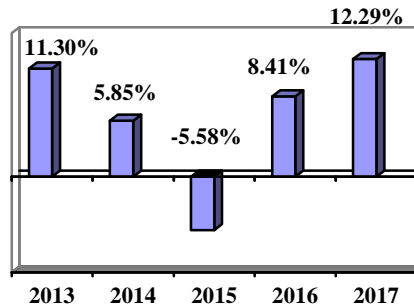
Statement of Fiduciary Net Position – This statement reports the assets, liabilities, and resultant net position restricted for pension benefits. This statement should be read with the understanding that it discloses the Plan’s financial position on September 30, 2017.

Statement of Changes in Fiduciary Net Position – This statement reports the results of operations during the years, categorically disclosing the additions to and deductions from plan net position. The net increase to plan assets on this statement support the change in net position restricted for pension benefits on the Statement of Fiduciary Net Position.

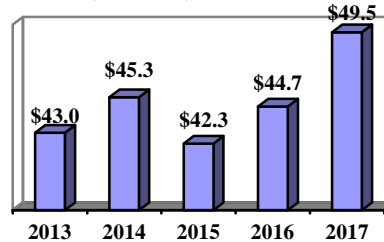
Notes to the Financial Statements:

The financial statement notes provide additional information that is essential to a full understanding of the data provided in the fund financial statements.

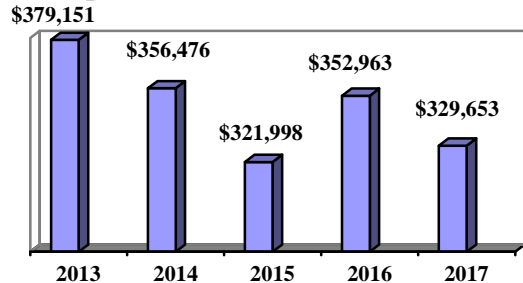
Plan Rate of Returns (2013-2017)



\$ Assets (millions)



Investments and administrative expenses



Firemen's Relief and Retirement Fund
of McAllen, Texas
Management's Discussion and Analysis
September 30, 2017

THE PLAN FINANCIAL ANALYSIS

The plan provides retirement benefits to essentially all eligible firefighter employees. These benefits are funded through member contributions, employer contributions, and earnings on investments. Total net position held in trust for pension benefits at September 30, 2017 amounted to \$49,459,309.

Additions to Net Position

Additions to the Plan net position held in trust for pension benefits include contributions from members and employer and net investment income. Member contributions totaled \$1,266,209 and employer contributions amounted to \$1,498,194. The Plan recognized net investment gain of \$5,489,970. This net investment gain was attributable to a combination of the following: a market appreciation of \$4,729,605; interest and dividends of the portfolio in the amount of \$1,016,954; gain in the sale of investments during the year amounting to \$39,242; and investment management expenses in the amount of \$295,831.

<u>Additions to Net Position</u>	<u>2017</u>	<u>2016</u>
Member contributions	\$ 1,266,209	\$ 1,265,734
Employer contributions	1,498,194	1,554,567
Net investment income	<u>5,489,970</u>	<u>3,571,662</u>
Total net additions	<u>\$ 8,254,373</u>	<u>\$ 6,391,963</u>

Deductions From Plan Net Position

Deductions from the Plan net position held in trust for pension benefits are comprised primarily of retirement benefit payments to the Plan retirees, survivors, and beneficiaries. Administrative expenses and refunds of contributions are also included as deductions. For 2017, benefit payments to retirees, survivors, and beneficiaries amounted to \$3,205,562. The administrative expenses amounted to \$33,822; and refunds to terminated employees—\$32,196 and DROP distribution—\$282,539. This combined amount totaled \$314,586. Two beneficiaries were added during the year and one retiree died during this time period. In addition, one widow receiving benefits died and one new widow was added in this time period. The combination of these events will add a net additional cost to the plan of approximately \$149,883.

Firemen's Relief and Retirement Fund
of McAllen, Texas
Management's Discussion and Analysis
September 30, 2017

<u>Deductions From Net Position</u>	<u>2017</u>	<u>2016</u>
Benefit payments	\$ 3,205,562	\$ 2,886,958
Refund to terminated employees	32,196	39,524
Drop payments	282,539	950,484
Administrative expenses	<u>33,822</u>	<u>56,906</u>
 Total deductions	 <u><u>\$ 3,554,119</u></u>	 <u><u>\$ 3,933,872</u></u>

Investments

Upon approval by the board of trustees, several realignments in the portfolio were made without changing the investment strategy. Total investments, exclusive of cash holdings and accrued interest receivable, amounted to \$47,657,245 at September 30, 2017. The estimated rate of return of the Plan was approximately 12.29% for the current year. For the year, the fund was able to meet its actuarial rate of return of 7.5 percent. The Plan's board of trustees and its consultant remain confident in the long-term potential of the portfolio to deliver upon the desired results of performance in excess of the actuarial requirement with appropriate levels of risk. The approach has served the Plan well historically and the Plan sees no reason to believe it is not attainable going forward.

The following table represents the fair value of investments of the Plan:

Investments at Fair Value

	<u>2017</u>	<u>2016</u>
Fixed income	\$ 8,314,170	\$ 8,118,321
Domestic and international equities	28,771,737	26,744,450
Mutual funds	2,298,348	2,112,358
Alternative investments	<u>8,272,990</u>	<u>7,503,629</u>
 Total assets	 <u><u>\$ 47,657,245</u></u>	 <u><u>\$ 44,478,758</u></u>

REQUESTS FOR INFORMATION

This Annual Financial Report is designed to provide a general overview of the Firemen's Relief and Retirement Fund of McAllen, Texas finances for interested parties. Questions concerning any of the information provided herein, or requests for additional financial information, should be addressed to Firemen's Relief and Retirement Fund of McAllen, Texas, P.O. Box 220, McAllen, Texas 78505-0220.

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Financial Statements

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Statement of Fiduciary Net Position

September 30, 2017

Assets

Cash and cash equivalents	\$ 1,789,673
Accrued interest receivable	15,469
Investments at fair value:	
Fixed income	8,314,170
Domestic and international equities	28,771,737
Mutual funds	2,298,348
Alternative investments	<u>8,272,990</u>
Total assets	<u>49,462,387</u>

Liabilities

Accounts payable	<u>3,078</u>
Total liabilities	<u>3,078</u>
Net position restricted for pension	<u><u>\$ 49,459,309</u></u>

The accompanying notes are an integral part of these statements.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Statement of Changes in Fiduciary Net Position

Year Ended September 30, 2017

Additions

Contributions:

Members	\$ 1,266,209
Employer	1,498,194

Total contributions	2,764,403
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Investment income:

Net appreciation in fair value of investments	4,729,605
Gain on sale of investments	39,242
Interest and dividends	1,016,954

5,785,801

Less investment expense	295,831
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Net investment gain	5,489,970
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Total additions	8,254,373
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Deductions

Benefits paid directly to participants or beneficiaries	3,205,562
Refunds to terminated employees	32,196
DROP payments	282,539
Administrative expenses	33,822

Total deductions	3,554,119
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Net increase in net position	4,700,254
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Net position restricted for pension

Beginning of year	44,759,055
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End of year	\$ 49,459,309
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The accompanying notes are an integral part of these statements.

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Firemen’s Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

1. Plan Description

The provisions of Firemen’s Relief and Retirement Fund of McAllen, Texas (the “Plan”) are authorized by the Texas Local Fire Fighters’ Retirement Act (“TLFFRA”). The following brief description of the Plan is provided for general information purposes only. The Plan agreement should be referred to for more complete information. The Plan has an actuarial valuation performed biennially in accordance with Governmental Accounting Standards Board (“GASB”) Statement No. 67, *Financial Reporting for Pension Plans— an amendment of GASB Statement No. 25*. The most recent actuarial valuation was performed as of October 1, 2016. This valuation was rolled forward to September 30, 2017 in accordance with GASB No. 67.

Reporting Entity

The plan is sponsored by the City of McAllen, Texas (the “City”). The Plan does not purport and does not present the financial position or changes in financial position of the City as of any time or for any period. The Plan meets the criteria of a “fiduciary fund” of the City as established by GASB, and certain information regarding the Plan is included in the City’s financial statements.

Plan Membership

The Pension Board of Trustees is the administrator of the Plan, which consists of current and former fire fighters of the City, as well as certain beneficiaries of current and former fire fighters. The City is the only contributing employer. The fire fighters covered by the Plan also contribute to the Plan. The types of employees covered, as well as Plan membership data, are as follows:

Number of participants:		
Actives members		170
Retirees and beneficiaries entitled to benefits		103
Retirees and beneficiaries entitled to, but not yet receiving benefits		<u>0</u>
Total Participants		<u>273</u>

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

1. Plan Description (continued)

Plan Benefits

Service Retirement Benefits

A member is eligible for service retirement upon completion of 20 years of service and attainment of age 50. A member who retires under the service retirement provisions of the fund will receive a monthly benefit equal to the sum of (a), (b), and (c) where: (a) equal to 2.9 percent of the member's highest 60-month average salary for each of the member's years of service up to and including the 20th year of service and (b) equals the greater of 2.9 percent of the member's highest 60-month average salary, or \$58.00 per month for each of the member's 21st and 22nd years of service, and (c) equals \$58.00 per month for each year of service in excess of 22 years.

Disability Benefits

An active member who becomes disabled as defined in the plan will receive a monthly disability benefit. Separate disability benefits are provided for duty-related and off-duty disabilities. Disability benefits are payable in the same joint-and-survivor form as service retirement benefits. However, disability benefits stop if the member recovers to the point that he no longer meets the definition of disability under the fund. If the total monthly amount a disabled member receives from (a) the fund, (b) workers compensation, and (c) the City of McAllen, exceeds the member's monthly rate of pay as of his

date of disability, the amount payable from the fund will be reduced so that the member's benefit from all three sources, combined, does not exceed such rate of pay.

Duty-related death benefits, payable to a member's spouse for as long as they are living, equal the sum of (a) 38.67% of the member's highest 60-month average salary, (b) plus two-thirds of any additional service benefit earned by the member as of the date of their death. The death benefit is payable for life, but it ceases upon remarriage. Effective January 1, 2006 the widowed spouse of a member who completed 10 or more years of service prior to their death will have the death benefit payments terminated in the event of remarriage. In addition to the above spousal death benefit, each unmarried child of the member will receive a monthly benefit of 7.73 percent of the fire fighter's highest 60-month average salary. Orphan benefits continue until the child reaches age 18. However, benefits will continue until age 22 for a child who is a full-time student. If the member's spouse dies or remarries, or if the member has no spouse on the date of their death, each eligible orphan will receive a monthly benefit of 15.47 percent of the member's highest 60-month average salary. Orphan benefits are continued for life for disabled children. The total of all benefits paid as a result of the death of an active fund member may not exceed the disability or retirement benefits such member had earned as of the date of their death. The total of all benefits paid as a result of the death of a retired member may

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

1. Plan Description (continued)

not exceed the retirement benefit the member was receiving as of the date of their death. Benefits are reduced pro rata, if necessary, in order to satisfy these limitations.

Termination Benefits

Members who terminate employment with less than 10 years of service will be entitled to the return of the excess of their contributions to the fund over the amount of any benefits they have received from the Plan. Such refunds will not include any interest on the members' contributions. If members terminate on or after the date they have completed 10 years of service but prior to the date they complete 20 years of service, they will be entitled to receive a monthly benefit, starting on the date they would have both completed 20 years of service and attained age 50, had they remained in the service of the fire department.

The amount the members will receive will equal the monthly service retirement benefit they had accumulated on the date they separated from service with the fire department, multiplied by the vested percentage of the members.

The Deferred Retirement Option Plan (DROP)

A member is eligible to receive their benefits under the plan's DROP provision after they have both completed 20 years of service and attained age 53. The election to participate in the DROP may be made at the time the member elects to retire. The monthly retirement income payable to a member who retires under the DROP will equal their service retirement benefits under the plan based on highest 60-month average salary and years of service as of the member's DROP Eligibility Date. The member's benefit will be calculated, however using the benefit formula in effect on the member's actual date of retirement. A member's DROP Eligibility Date is the later of (a) the date the member meets the eligibility requirements for the DROP or (b) the date which is two years prior to the member's actual retirement date: Upon retirement, the member will receive—in addition to their monthly retirement benefit—a single payment equal to the sum of: (a.) the total of the monthly retirement benefits the member would have received between his DROP Eligibility Date and the time they retired under the plan, and (b.) the amount of monthly contributions that the member has made to the fund between their DROP Eligibility Date and the time they retired under the plan. Since the member does not elect a DROP until actual retirement, Plan does not have any DROP accounts or liabilities reported for DROPS at September 30, 2017.

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

2. Summary of Significant Accounting Policies and Plan Asset Matters

Organization

The Plan was created pursuant to the TLFFRA. The Plan provides pension, disability, death, and severance benefits to employees of the City's fire department and former volunteer firemen eligible to receive benefits pursuant to a single-employer defined benefit pension plan.

Basis of Accounting

The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America for local governmental units as prescribed by the GASB. The financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. Benefits and refunds are recognized when due and payable in accordance with the terms of the Plan.

Cash Equivalents

For purposes of the statement of fiduciary net position, short-term, highly liquid investments are considered cash equivalents. Highly liquid investments are defined as investments with a maturity date of three months or less at time of purchase.

Valuation of Plan Investments

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. The Plan's investments are stated at fair value and, accordingly, unrealized appreciation and depreciation are reported in the statement of changes in fiduciary net position. The fair value of money market funds is considered to be the same as the cost of these investments due to their highly liquid nature. The fair value of common stocks and foreign equities are based on quoted market prices. The fair value of United States Government securities and corporate and foreign bonds are based on quotes from broker dealers or are valued using interest rate curves and credit spreads applied to the terms of the debt instrument (maturity and coupon interest rate) and considering the counterparty rating. The Plan values investments in alternative funds based on its percentage investment in each such fund and are reported at net asset value (NAV). The estimated fair value of each fund is based on market conditions and information reported by the fund manager, and is generally based on the estimated fair value of each fund's underlying investments at the end of the reporting period.

Purchases and sales of investments are recorded on a trade-date basis and, accordingly, the related receivables and payables for any unsettled trades are recorded. Interest income and dividends are recorded on the accrual basis.

**Firemen’s Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2017

2. Summary of Significant Accounting Policies and Plan Asset Matters (continued)

Federal Income Tax

The Plan is exempt from federal income tax pursuant to applicable regulations.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Plan administrator to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

3. Fiduciary Fund of the City of McAllen, Texas

Due to the level of oversight responsibility exercised, the Plan is included in the City’s basic financial statements in the fiduciary fund section. Certain administrative functions are performed for the Plan by the City at no cost. The City is under no legal obligation to fund any unfunded pension obligations related to the Plan, other than to fund the actuarially determined annual required contribution. See note 10 for additional information.

4. Net Pension Liability of the City

Total pension liability is developed by subtracting the present value of future service costs from the present value of future benefits. The net pension liability is calculated by subtracting the plan fiduciary net position from the total pension liability. The components of the net pension liability of the City at September 30, 2017 were as follows:

Total pension liability	\$ 75,091,715
Plan fiduciary net pension	<u>49,459,309</u>
City's net pension liability	<u><u>\$ 25,632,406</u></u>
Fiduciary net position	
as a percentage of total pension liability	65.87%

**Firemen’s Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2017

4. Net Pension Liability of the City (continued)

Actuarial Assumptions

The total pension liability was determined by an actuarial valuation as of October 1, 2016 which was rolled forward to the measurement date of September 30, 2017, the Plan’s fiscal year end, and can be found on the following page.

Valuation date	October 1, 2016, rolled forward to September 30, 2017
Measurement date	September 30, 2017
Actuarial cost method	Entry age
Amortization method	Level percentage of payroll, open
Actuarial assumptions:	
Investment rate of return	7.5% per annum, compounded annually
Projected salary increases	4.00% to 8.60%, including inflation based on service at attained age (fund specific)
Inflation	3.00% per year
Cost-of-living adjustment	None
Mortality	Employee and health annuitant combined rates from the RP-2000 Mortality Table, projected to 2024 using Scale AA, with separate rates for males and females
Other information	There have been no benefit changes since the October 1, 2016 valuation date

The investment rate of return and the projected salary increases both used the same assumptions with regard to inflation. The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimates of expected future real rates of return 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 allocation percentage and by adding expected inflation. Best estimates or arithmetic real rates of return for each major asset class included in the Plan’s target allocation as of September 30, 2017 are summarized in the following table:

**Firemen’s Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2017

4. Net Pension Liability of the City (continued)

<u>Asset class:</u>	<u>Target allocation</u>	<u>Long-term expected real rate of return</u>
Cash	0.63%	0.00%
Fixed income	22.86%	3.00%
Equities		
(a) Domestic	43.48%	7.25%
(b) International	16.27%	5.75%
Alternative investments	16.76%	3.00%

Discount Rate

The discount rate used to measure the total pension liability was 7.50%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from the City will be made at contractually required rates. Based on this assumption, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return for the 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 table below presents the net pension liability of the City calculated using the discount rate of 7.50%, as well as what the net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.50%) or one percentage point higher (8.50%).

	<u>One Percent Decrease (6.50 Percent)</u>	<u>Current Discount Rate (7.50 Percent)</u>	<u>One Percent Increase (8.50 Percent)</u>
Net pension liability	<u>\$ 39,339,224</u>	<u>\$ 25,632,406</u>	<u>\$ 21,674,434</u>

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

4. Net Pension Liability of the City (continued)

Money-weighted rate of return

For the year ended September 30, 2017, the annual money weighted rate of return was calculated at 12.54%. The calculation was determined based on rate of return on pension plan investments, net of pension plan investment expense. Inputs to the money-weighted internal rate of return calculation were determined at least monthly.

5. Benefits

Benefit provisions are established under authority of the TLFFRA. Specific plan provisions are governed by a Plan document and a trust agreement executed by the Board of Trustees. The Plan document may be amended as provided in Section 7 of the Texas Fire Fighters' Retirement Act (Article 6243e, V.T.C.S.). Amending the Plan requires approval of any proposed change by an eligible actuary and a majority of the participating members of the Plan. Both the City and the members of the Plan have specific authority to appoint members of the Board of Trustees under the TLFFRA.

6. Contributions

The Plan's minimum required contribution provisions are established under Title 8, Subtitle A, Chapter 802, Subchapter B, Section 802.101 of the Texas Government Code and under Texas Pension Review Board Guidelines for Actuarial Soundness. Specific Plan contribution rates are governed by the Plan document. Changes in the members' or the City's contribution rate requires a plan amendment.

The contribution rates of the Plan members and the City are established under the terms of the Plan. An actuarial valuation is performed biennially to verify that Plan benefits and Plan contributions are in balance. Costs of administering the fund are paid from Plan assets.

Pursuant to the Plan document, a legal instrument binding both the City and its firefighters, the City of McAllen is required to match members' contributions. Benefits paid to former volunteer firefighters are funded by the City when paid to the former volunteer firefighters or beneficiaries. The City's contribution rate for the fiscal year ended September 30, 2017 was 13.00% of annual compensation. Contributions required and paid into the fund as of September 30, 2017 were \$1,266,209 (members) and \$1,498,194 (employer).

**Firemen's Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2017

7. Deposits With Financial Institutions and Investments

The deposits and investments of the Plan are held separately from those of the City. The TLFFRA authorizes the Plan to invest in:

- Obligations and securities of the United States, the state of Texas, or any county, city, or other political subdivision of the state of Texas;
- Savings and loan association accounts insured by the Federal Deposit Insurance Corporation;
- First lien real estate mortgage securities insured by the Federal Housing Administration;
- Corporate bonds and stocks;
- Guaranteed investment contracts offered by insurance companies;
- Money market funds;
- Mutual funds and other pooled funds; and
- International stocks traded as American Depository Receipts;
- Derivatives; and
- Alternative investments.

**Firemen’s Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2017

7. Deposits With Financial Institutions and Investments (continued)

Investments

Investments at fair value as of September 30, 2017 are as follows:

	<u>Fair Value</u>	<u>% of Portfolio</u>	<u>Investment Policy of Asset Allocation</u>
Equities:			
Domestic	\$ 19,826,737	42%	30-60%
International	8,945,000	19%	10-30%
Total equities	<u>28,771,737</u>		
Fixed income:			
Treasury and agency securities corporate bonds and mutual funds	<u>10,612,518</u>		
Total fixed income	<u>10,612,518</u>	22%	20-50%
Alternative funds	<u>8,272,990</u>	17%	0-20%
Total investment portfolio	<u>\$ 47,657,245</u>	100.00%	

The Plan categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs, quoted market prices of similar assets in non-active markets, and inputs other than quoted that are observable either directly or indirectly; Level 3 are significant unobservable inputs and may include situations where there is minimal, if any, market activity.

The Plan uses a matrix pricing model (Level 1-3 inputs) to measure the fair market value of its government security investments.

**Firemen’s Relief and Retirement Fund
of McAllen, Texas**

Notes to Financial Statements

September 30, 2017

7. Deposits With Financial Institutions and Investments (continued)

Fair Value Measurement

Investments at fair value as of September 30, 2017 using the fair value measurement are as follows:

Investment Type	Total Fair Value	Level 1	Level 2	Level 3
Equities				
Domestic Equity	\$ 9,675,992	\$ 9,675,992	\$ -	\$ -
International Equity	6,724,698	1,677,612	5,047,086	-
Mutual Fund	2,298,348	2,298,348	-	-
Fixed Income				
Fixed Income Mutual Fund	6,079,323	745,874	5,333,449	-
US Treasury Notes	1,506,876	-	1,506,876	-
Mortgage Backed Securities	398,682	-	398,682	-
Corporate Bonds	264,791	-	264,791	-
Municipal Bonds	64,498	-	64,498	-
Total Investments at Fair Value	<u>\$ 27,013,208</u>	<u>\$ 14,397,826</u>	<u>\$ 12,615,382</u>	<u>\$ -</u>

Investments measured at the net asset value (NAV)

Equity Growth Fund	10,150,745			
Emerging Markets Equity Fund	2,220,302			
Hedge Funds		Unfunded Commitments	Redemption Frequency	Redemption Notice
Courage Credit Opportunities Offshore Fund III LP	1,202,281	879,792	(1)	(1)
Ironwood	2,232,865	-	Semi-annual	95 days
Titan	2,260,980	-	Quarterly	65 days
Cielo	329,218	-	(1)	(1)
Terracap	2,247,646	-	(1)	(1)
Total of Investments Measured at NAV	<u>20,644,037</u>			
Total Investments	<u><u>\$ 47,657,245</u></u>			

(1) These hedge funds are not redeemable. The Firemen’s Relief and Retirement Fund receives distributions as the underlying assets of investments are sold/liquidated. Management estimates that the remaining three hedge funds (\$3,779,145 or 45.68%) will liquidate in 5-7 years.

The Firemen’s Relief and Retirement Fund is invested in five hedge funds. Portfolios for these funds include investments in common stock, United States government obligations, convertible securities, debt instruments, real estate assets, and collateralized debt securities. Fair values have been determined using NAV per share of investments. These hedge funds represent 17.36% of the Firemen’s Relief and Retirement Fund. Two of the five hedge funds, Ironwood and Titan, (represent \$4,493,845 or 54.32%). Ironwood is eligible for redemption on a semi-annual basis with a 95 day formal notice and Titan is eligible for redemption on a quarterly basis with a 65 day notice.

Firemen’s Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

7. Deposits With Financial Institutions and Investments (continued)

Because of the complexity of the portfolio, the Board of Trustees uses a consultant to provide the guidance to accomplish the Plan’s objectives. The Board also understands that return objectives can be achieved while assuming “market” volatility. The Board is willing to forego potential return in strong markets in return for protection against a severe decline during weak periods.

Concentration of credit risk. As noted page 19, none of the sectors exceed their percentage of asset allocation. The Plan is diversified; with no one issue exceeding 5%. Under normal market conditions, the portfolio can be liquidated within one to two days if so desired. Two of our alternate investments are Ironwood and Titan. Ironwood is eligible for redemption on a semi-annual basis with a 95 day formal notice and Titan is eligible for redemption on a quarterly basis with a 65 day notice.

Interest rate risk. Only the fixed income securities of the Plan are subject to interest rate risk due to the possibility that prevailing interest rates could change before the securities reach maturity. Securities that are subject to interest rate risk as of September 30, 2017 amount to \$8,314,170 and have weighted-average duration of 11.67 years. Duration is defined as the change in the value of a fixed income security that will result from a 1% change in interest rates. Duration is stated in years. For example, five year duration means the bond will decrease in value by 5% if interest rates rise 1% and increase in value by 5% if interest rates fall 1%. The investment policy is silent on the subject of interest risk. Securities that are subject to interest rate risk are shown in the following table.

Investment Type	Fair Value	Percentage of Total	Weighted-Average Duration (Years)
Corporate bonds	\$ 264,791	3.18%	16.39
US Treasury Notes	1,506,876	18.12%	6.60
Mutual fund bonds	6,079,323	73.12%	6.57
Government Mortgage Back Securities	398,682	4.80%	5.34
Municipal Bonds	64,498	0.78%	23.46
	<hr/>		<hr/>
Total fixed income investments	<u>\$ 8,314,170</u>	100.00%	<u>11.67</u>

Custodial credit risk. Custodial credit risk is the risk that in the event of a failure of the counterparty, the Plan will not be able to recover the value of investments or collateral in possession of the counterparty. The Plan does not have a policy regarding custodial credit risk. The Plan does not have any cash deposits held with financial institutions and all investments are held in the name of the Plan.

Firemen’s Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

7. Deposits With Financial Institutions and Investments (continued)

Credit risk. Using Standard and Poor’s rating system for fixed income securities as of September 30, 2017 the Plan’s fixed income investments were rated as noted below. The investment policy is silent on the subject of credit risk.

Investment Type	Fair Value	S & P Ratings		
		AA	A	Not Rated
Fixed Income Mutual Funds	\$ 6,079,323	\$ -	\$ -	\$ 6,079,323
US Treasury Notes	1,506,876	1,506,876	-	-
Mortgage Back Securities	398,682	398,682	-	-
Corporate Bonds	264,791	47,046	166,561	51,184
Municipal Bonds	64,498	-	-	64,498
	<u>\$ 8,314,170</u>	<u>\$ 1,952,604</u>	<u>\$ 166,561</u>	<u>\$ 6,195,005</u>

8. Risks and Uncertainties

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market rate, 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 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 the 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.

9. Change in State Oversight Agency

An agency from the State of Texas conducted a sunset review of the Texas Local Fire Fighters’ Retirement agency. After the review, it was determined that this agency should be abolished and its duties were transferred to the Pension Review Board, another state agency. The Pension Review Board agency is currently assessing its additional responsibilities towards the local pension plans, which will now fall under its jurisdiction.

Firemen's Relief and Retirement Fund of McAllen, Texas

Notes to Financial Statements

September 30, 2017

10. Funding Responsibility

In September 2003, Texas voters approved an amendment to the Texas Constitution, which provided that once certain benefits are granted to retirees, those benefits may not be subsequently reduced. It was codified as Article XVI, Section 66, of the Texas Constitution. The amendment applies only to the City of McAllen Firefighters' Relief and Retirement Plan. It further provided that the City and the retirement system that finance benefits under the retirement system are jointly responsible for ensuring that benefits are not reduced or otherwise impaired, which could potentially require the City to involuntarily increase its funding due to under-performing investments, plan improvements as well as other factors outside the control of the City. The amendment also permitted the City to be exempt from its requirements upon holding an election in which the majority of the votes favored the exemption. On May 15, 2004, a special City election was held, in which the majority of the voters voted in favor of exempting the City of McAllen and the McAllen Firefighters' Relief and Retirement Plan from the application of this amendment, Article XVI, Section 66 of the Texas Constitution.

Required Supplementary Information

Firemen's Relief and Retirement Fund of McAllen, Texas

Required Supplementary Information – (Unaudited)

Schedule of: Changes in Net Pension Liability and Related Ratios; Investment Returns

Discount Rate	7.50%	7.50%	7.50%	7.50%
Annual Increase in Payroll	4.25%	4.00%	4.00%	4.00%
Measurement Date	<u>9/30/2014</u>	<u>9/30/2015</u>	<u>9/30/2016</u>	<u>9/30/2017</u>
Total Pension Liability				
1. a. Service Cost (Pension benefits)	\$ 1,549,238	\$ 1,778,456	\$ 1,544,544	\$ 1,536,125
b. Service Cost (Administrative expenses)	23,959	46,070	352,963	329,653
c. Adjustment For Change in Attribution Period	-	-	982,134	-
2. Interest	4,841,219	4,884,830	5,130,946	5,361,757
3. Changes in Benefit Terms	-	-	-	-
4. Difference Between Expected and Actual Experience	-	221,439	-	(1,202,731)
5. Changes in Assumptions	-	(3,414,995)	-	-
6. Benefit Payments (including refunds of member contributions)	(2,588,586)	(3,170,707)	(3,876,966)	(3,520,297)
7. Net Change In Total Pension Liability	3,825,830	345,093	3,151,487	2,504,507
8. Total Pension Liability-Beginning of the Year	64,282,664	68,108,494	68,453,587	72,587,208
9. Total Pension Liability-End of the Year	68,108,494	68,453,587	72,587,208	75,091,715
Plan Fiduciary Net Position				
10. Contributions - employer	1,435,293	1,477,483	1,554,567	1,498,194
11. Contributions - members	1,214,786	1,223,445	1,265,734	1,266,209
12. Expected Net Investment Income	2,525,951	3,376,943	3,119,711	5,489,970
13. Gain or (Loss) Due to Difference in Projected vs Actual Earnings	-	(5,843,966)	748,008	-
14. Benefit Payments (including refunds of member contributions)	(2,588,586)	(3,170,707)	(3,876,966)	(3,520,297)
15. Expected Administrative Expenses	(23,959)	(46,070)	(352,963)	(33,822)
16. Other	(1)	-	(2)	-
17. Net Changes in Plan Fiduciary Net Position	2,563,484	(2,982,873)	2,458,091	4,700,254
18. Plan Fiduciary Net Position-Beginning of the Year	42,720,353	45,283,837	42,300,964	44,759,055
Plan Fiduciary Net Position-End of the Year	45,283,837	42,300,964	44,759,055	49,459,309
19. Net Position Liability-End of the Year (line 9 minus line 18)	22,824,657	26,152,623	27,828,153	25,632,406
20. Plan Fiduciary Net Position as a Percentage of the Total Pension Liability-End of the Year	66.49%	61.80%	61.66%	65.87%
21. Covered Employee Payroll	11,043,509	11,365,262	11,515,311	11,524,569
22. Net Pension Liability-End of the Year as a Percentage of Covered Employee Payroll	206.68%	230.11%	241.66%	222.42%
23. Annual Money-weighted Rate of Return Net of Pension Plan Investment Expense With Inputs Determined At Least Monthly	5.90%	-5.44%	8.54%	12.54%

Note 1: In accordance with Paragraph 50 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 67 Statement have not been included.

Note 2: The Plan adjusted the Total Pension Liability for the estimated effect of a reduction in attribution period for employees expected to elect a BackDrop. The estimated effect is accounted for under item 1.c. above.

**Firemen's Relief and Retirement Fund
of McAllen, Texas**
Required Supplementary Information - (Unaudited)
Schedule of Contributions

Fiscal Year	(1) Actuarial determined contribution	(2) Contribution in relation to the actuarially determined contribution	(3) Contribution excess (deficiency) (2) -(1)	(4) Covered employee payroll	(5) Contributions as a percentage of covered employee payroll (2)/(4)
2008	\$ 935,980	\$ 935,980	\$ -	\$ 6,817,267	13.73%
2009	1,065,018	1,065,018	-	8,199,849	12.99%
2010	1,144,532	1,144,532	-	8,199,849	13.96%
2011	1,234,674	1,234,674	-	8,996,407	13.72%
2012	1,287,288	1,287,288	-	8,996,407	14.31%
2013	1,337,910	1,337,910	-	9,361,646	14.29%
2014	1,435,293	1,435,293	-	11,043,509	13.00%
2015	1,477,483	1,477,483	-	11,365,262	13.00%
2016	1,554,567	1,554,567	-	11,515,311	13.50%
2017	1,498,194	1,498,194	-	11,524,569	13.00%

**Firemen's Relief and Retirement Fund
of McAllen, Texas**
Required Supplementary Information - (Unaudited)
Schedule of Contributions

Actuarial Assumptions

The total pension liability was determined by an actuarial valuation as of October 1, 2016 and rolled forward to the measurement date of September 30, 2017, the Plan's fiscal year end.

Valuation date	October 1, 2016, rolled forward to September 30, 2017
Measurement date	September 30, 2017
Actuarial cost method	Entry age
Amortization method	Level percentage of payroll, open
Actuarial assumptions:	
Investment rate of return	7.5% per annum, compounded annually
Projected salary increases	4.00% to 8.60%, including inflation based on service at attained age (fund specific)
Inflation	3.00% per year
Cost-of-living adjustment	None
Mortality	Employee and health annuitant combined rates from the RP-2000 Mortality Table, projected to 2024 using Scale AA, with separate rates for males and females
Other information	There have been no benefit changes since the October 1, 2016 valuation date

**Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in
Accordance With *Government Auditing Standards***

To the Pension Board of Trustees
Firemen's Relief and Retirement Fund

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Firemen's Relief and Retirement Fund (the Plan), a fiduciary fund of the City of McAllen, Texas, as of and for the year ended September 30, 2017, and the related notes to the financial statements, which collectively comprise the Plan's financial statements, and have issued our report thereon dated February 27, 2018. The financial statements present only the financial position of the Plan, a fiduciary fund of the City of McAllen, Texas, and do not purport to, and do not, present the financial position of the City of McAllen, Texas, as of September 30, 2017, and the changes in financial position for the year then ended.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of This Report

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

RSM US LLP

San Antonio, Texas
February 27, 2018