

RETIREE HEALTH CARE PLAN

**Financial Statements and Supplementary Information
For the Years Ended December 31, 2016 and 2015
With Independent Auditor's Report**



MITCHELL TITUS
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RETIREE HEALTH CARE PLAN

For the Years Ended December 31, 2016 and 2015

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INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
Retiree Health Care Plan

Report on the Financial Statements

We have audited the accompanying financial statements of the Retiree Health Care Plan (the Plan), which comprise the statements of plan net position as of December 31, 2016 and 2015, the related statements of changes in plan net position for the years 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.

Auditor's Responsibility

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

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

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

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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 2015, and the changes in its financial position for the years 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 the required supplementary information 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 audits 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 Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying schedule of investment and administrative expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Mitchell Titus, LLP

September 29, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Management's discussion and analysis of the Retiree Health Care Plan (the Plan) provides an overview and analysis of the financial statements of the Plan, including highlights and a discussion of current activities for the years ended December 31, 2016 and 2015. For more detailed information regarding the Plan's financial activities, readers should also review the Plan's financial statements, including the notes and supplementary schedules.

Overview of the Financial Statements

The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America as established by the Governmental Accounting Standards Board (GASB) and are described below:

- *The Statement of Plan Net Position* presents the Plan's assets and liabilities and the resultant net position held in trust for plan benefits at year end. This statement reflects the Plan's investments at fair value as well as receivables and liabilities.
- *The Statement of Changes in Plan Net Position* presents the additions and deductions to the Plan during the current year. It reflects the investment income and net realized and unrealized gains or losses during the year, along with members' contributions and employer's contributions, if any, as well as benefit payments and administrative expenses.
- *The Notes to Financial Statements* provide additional information for a better understanding of the data provided in the financial statements. They explain the purpose of the Plan, significant accounting policies, investment details and related risks, and other relevant information.

The required supplementary information consists of a Schedule of Funding Progress, a Schedule of Contributions from Employer and Other Contributing Entities, as well as the related notes to discuss actuarial assumptions and methods. Such schedules provide the historical trend information for the Plan since its adoption of GASB Statement No. 43 to aid in the analysis of the funded status of the Plan and the progress being made in accumulating sufficient assets to pay benefits when due.

- *The Schedule of Funding Progress* contains actuarial valuations of the status of the Plan in an ongoing as well as historical basis. Actuarial liabilities in excess of the actuarial value of assets indicate that insufficient assets have been accumulated to fund future benefits of current members and retirees. Conversely, actuarial value of assets in excess of actuarial accrued liabilities indicates that the Plan is overfunded.
- *The Schedule of Contributions from Employer and Other Contributing Entities* contains historical trend information of employer contributions and other contributing entities. It shows the value of total annual contributions the employer must pay as determined under the parameters in GASB Statement No. 43 and the related percentage the employer has contributed to meet its requirement.
- *The Notes to Required Supplementary Information* describe the actuarial method and assumptions used to aid in the understanding of the required supplementary schedules.

The additional schedule provided consists of the *Schedule of Investment and Administrative Expenses*, which reflects the costs to manage the Plan.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Financial Highlights

- Public Act 094-0839, which passed in June 2006, separated the funding for retiree health care benefits from funding for pension benefits by January 1, 2009.
- Public Act 095-0708, which was signed by the Governor on January 18, 2008, established the Retiree Health Care Trust (RHCT, or the Plan) and provided for funding and benefit changes to the retiree health care benefits. Beginning January 18, 2008, all Chicago Transit Authority (CTA) employees were required to contribute 3% of their compensation into the newly formed RHCT. The legislation also required changes to eligibility for health care benefits from the RHCT. Contributions from retirees, dependents, and survivors may not exceed 45% of the total cost of their benefits under the Plan. Public Act 095-0708 also authorized the CTA to issue pension obligation bonds to fund the RHCT. After the bond funding, the legislation provides that the CTA has no further obligation to provide funding for health care benefits to eligible retirees and their dependents and survivors. During 2016, 2015 and 2014, CTA employees' contributions remained at 3% of their compensation.
- The RHCT was established on May 12, 2008. Approximately \$529 million from bond proceeds was deposited in the RHCT in August 2008.
- During 2009, the RHCT's Board of Trustees developed the plan design and eligibility rules for retirees, which were required pursuant to Public Act 095-0708, and entered into contracts with health care providers to provide benefits to retirees, dependents, and surviving spouses. In May 2009, the RHCT held its first open enrollment for retirees, dependents, and survivors. All who elected coverage with RHCT began on July 1, 2009.
- Retiree and employee contributions totaled \$39.6 million, \$39.2 million, and \$39.4 million for the years ended December 31, 2016, 2015 and 2014, respectively.
- Net investment income (loss) was \$44.0 million, \$(4.5) million, and \$24.6 million for the years ended December 31, 2016, 2015 and 2014, respectively.
- The Plan's net position totaled \$750.5 million, \$716.9 million, and \$732.6 million at December 31, 2016, 2015, and 2014, respectively.
- The funded ratio of the Plan was 130.2%, 131.1%, and 134.0% at December 31, 2016, 2015 and 2014, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Plan Net Position

The following schedule presents the Plan's net position:

Plan Net Position

(in millions)

As of December 31, 2016, 2015 and 2014

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2016-2015</u> <u>Change</u>	
				<u>\$</u>	<u>%</u>
Investments, at fair value	\$ 759.4	\$ 724.3	\$ 743.1	\$ 35.1	4.8 %
Employee contributions receivable	-	-	0.3	-	-
Retiree contributions receivable	1.4	1.4	1.5	-	-
Securities sold but not received	3.4	1.9	1.8	1.5	78.9
Accrued interest and dividends	1.6	1.8	1.7	(0.2)	(11.1)
Other receivables	0.4	0.2	0.1	0.2	100.0
Prepaid expense	-	1.3	1.6	(1.3)	(100.0)
Total assets	<u>766.2</u>	<u>730.9</u>	<u>750.1</u>	<u>35.3</u>	
Accounts payable	3.7	3.9	4.7	(0.2)	(5.1)%
Securities purchased but not paid	12.0	10.1	12.8	1.9	18.8
Total liabilities	<u>15.7</u>	<u>14.0</u>	<u>17.5</u>	<u>1.7</u>	12.1
Plan net position	<u>\$ 750.5</u>	<u>\$ 716.9</u>	<u>\$ 732.6</u>	<u>\$ 33.6</u>	4.7 %

Plan net position increased by \$33.6 million, or 4.7%, at December 31, 2016 compared to the prior year, primarily due to market conditions, which increased investments at year end by \$35.1 million rather than a decrease of \$18.8 million at December 31, 2015. Receivables increased by \$1.5 million at December 31, 2016, mainly due to increase in the securities sold but not received. Liabilities increased by \$1.7 million at December 31, 2016, caused by an increase in pending purchases of securities at year end.

Plan net position decreased by \$15.6 million, or 2.1%, at December 31, 2015 compared to the prior year, primarily due to market conditions, which decreased investments at year end by \$18.8 million rather than an increase of \$10.6 million at December 31, 2014. Receivables decreased by \$0.1 million at December 31, 2015, mainly due to a decrease in the employee contributions receivable. Liabilities decreased by \$3.5 million at December 31, 2015, caused by decreases in accounts payable and pending purchases of securities at year end.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Changes in Plan Net Position

The following schedule presents changes in the Plan's net position during the years:

Changes in Plan Net Position (in millions)

For the Years Ended December 31, 2016, 2015 and 2014

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2016-2015</u> <u>Change</u>	
				<u>\$</u>	<u>%</u>
Additions					
Employee contributions	\$ 21.0	\$ 20.7	\$ 19.9	\$ 0.3	1.4 %
Retiree contributions	18.6	18.5	19.5	0.1	0.5
Rebates and reimbursements related to claims	0.8	0.5	0.2	0.3	60.0
Net investment income	<u>44.0</u>	<u>(4.5)</u>	<u>24.6</u>	<u>48.5</u>	1077.8
Total additions	<u>84.4</u>	<u>35.2</u>	<u>64.2</u>	<u>49.2</u>	
Deductions					
Medical claims paid to providers	17.9	18.2	23.5	(0.3)	(1.6)%
Medical premium payments to insurance companies	28.1	27.8	26.0	0.3	1.1
Dental premium payments to insurance companies	2.1	1.9	1.4	0.2	10.5
Claim administration fee	1.3	1.3	1.3	-	-
Administrative expenses	<u>1.4</u>	<u>1.6</u>	<u>2.3</u>	<u>(0.2)</u>	(12.5)
Total deductions	<u>50.8</u>	<u>50.8</u>	<u>54.5</u>	<u>-</u>	
Net increase (decrease)	<u>\$ 33.6</u>	<u>\$ (15.6)</u>	<u>\$ 9.7</u>	<u>\$ 49.2</u>	(315.4)%

Total additions of \$84.4 million in 2016 were significantly higher than the amount in 2015, primarily due to a net investment gain of \$44.0 million in 2016 compared to a net investment loss of \$4.5 million in 2015. An increase in the 2016 total additions over 2015 represents an increase of \$49.2 million, or 139.8%.

Total additions of \$35.2 million in 2015 were significantly lower than the amounts in 2014, primarily due to a net investment loss of \$4.5 million in 2015 compared to a net investment gain of \$24.6 million in 2014. A decrease in the 2015 total additions over 2015 represents a decrease of \$29 million, or 45.2%.

Deductions for medical claims and administration fees for 2016 remained the same as 2015, with \$50.8 million. Medical claims paid to providers decreased by \$0.3 million but medical premiums payments to insurance companies increased by \$0.3 million. Dental premium payments to insurance companies increased by \$0.2 million while administrative expenses decreased by \$0.2 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Changes in Plan Net Position *(continued)*

Deductions for medical claims and administration fees for 2015 were \$50.8 million compared to \$54.5 million in 2014. Deductions decreased in 2015 by \$3.7 million, mainly due to a decrease in the medical claims paid to providers of \$5.3 million, or 22.6%, in 2015 compared to 2014. In 2015, there was a change in the Medicare Advantage Plan offered. Premium payments to insurance companies continued to increase in 2015 as more retirees enrolled into the Plan. Administrative expenses were \$0.7 million lower in 2015 compared to 2014 due to a decrease in legal fees and actuarial services.

Plan Membership

The following table presents the changes in Plan membership as of December 31, 2016, 2015 and 2014:

	2016	2015	2014	2016-2015	
				Change	%
Retirees and beneficiaries					
receiving benefits	8,795	8,944	9,028	(149)	(1.7)%
Active employees	10,329	10,234	10,519	95	0.9 %
Terminated (inactive members)					
employees entitled to benefits					
or refunds of contributions	108	115	99	(7)	(6.1)%
Total	<u>19,232</u>	<u>19,293</u>	<u>19,646</u>	<u>(61)</u>	<u>(0.3)%</u>

Funding Results on the Retiree Health Care Trust and Plan

Section 22-101B(b)(3)(iii) of the Illinois Pension Code requires the Board of Trustees of the RHCT to make an annual assessment of the funding levels of the RHCT and to submit a report to the Auditor General regarding the assessment. The purpose of the RHCT is to fund the expenses of the Retiree Health Care Plan. If the actuarial present value of projected benefits exceeds the actuarial present value of projected contributions and trust income plus assets in excess of the statutory reserve, then a plan should be implemented by management of the RHCT to increase the contribution levels from employees, retirees, dependents, or survivors; to decrease benefit levels or both, which is projected to cure the shortfall over a period of not more than 10 years. At December 31, 2016, 2015 and 2014, the funded ratio of the Plan was 130.2%, 131.1% and 134.0 %, respectively. The decrease in the funding ratio at December 31, 2016 was primarily due to assets being less than expected and changes in the covered population, including more complete data regarding accumulated hours since 2008; the decrease in the funding ratio at December 31, 2015 was primarily due to assets being less than expected; changes in the covered population; change to per capita claims, based on updated claim experience, along with changes to retiree contribution rates; and plan changes. Plan changes made in 2016 include adding a Medicare HMO option.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Investment Activities

The Plan's net position held for investment was \$759.4 million at year-end 2016, an increase of \$35.1 million compared to 2015, with a total Plan rate of return of 7.0%. Domestic equity investment managers returned a positive 13.2%, while non-U.S. equity investment managers returned a negative 1.7%, total fixed income returned a positive 4.3% and real estate managers returned a positive 9.8% for the year ended December 31, 2016. The Plan's net position held for investment was \$724.3 million at year-end 2015, a decrease of \$18.8 million compared to 2014, with a total Plan rate of return of negative 0.3%. Domestic equity investment managers returned a negative 0.1%, while non-U.S. equity investment managers returned a negative 2.1%, and total fixed income returned a negative 0.1% for the year ended December 31, 2015.

During 2014, new investment asset allocation was approved by the Board of Trustees as recommended by our Investment Consultants; therefore, the Plan began to move assets in-line with the newly adopted policy target. The restructuring of the asset allocation in the Plan was completed in 2015. Investment asset allocation for 2016 and 2015 was core fixed income 30%, non-U.S. fixed income 5%, emerging markets debt 5%, U.S. equity 35%, total non-U.S. equity 15%, and real estate 10%. During 2016 and 2015, the Plan's investment asset allocation stayed within its target asset allocation ranges.

Investment Return

(Calendar Year Performance Gross of Fees Basis)

For the Years Ended December 31, 2016, 2015 and 2014

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Total Health Care Trust	7.0%	(0.3)%	3.9%
Benchmark portfolio	7.9	(0.3)	6.6
Domestic equities	13.2%	(0.1)%	5.9%
Benchmark (Wilshire 5000 Total Market)	13.4	0.7	12.7
International equities	(1.7)%	(2.1)%	(5.3)%
Benchmark (MSCI ACWI ex USA)	4.5	(5.7)	(3.9)
Domestic fixed income	3.3%	0.5%	5.8%
Benchmark (Barclays U.S. Aggregate)	2.6	0.6	6.0
International fixed income	8.1%	(2.2)%	5.0%
Benchmark (Citigroup Non-U.S. Govt. Bond)	5.8	(2.4)	1.2
Real estate	9.8%	-	-
Benchmark (NFI)	8.8	-	-

Subsequent Events

During the monthly meeting of the Board of Trustees dated April 27, 2017, the eligibility for retiree health care coverage was changed. Effective January 1, 2018, participants would become eligible to receive health care benefits if they meet the following criteria (1) they separate from service at or after age 55 with at least 20 years of eligibility service, or (2) they separate with at least 10 years of service and are at least age 65 at the time they enroll.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

During the monthly meeting of the Board of Trustees dated March 31, 2017, the Board had expressed the desire to move forward with the implementation of a health reimbursement arrangement and directed the General Administration Committee of the Board of Trustees to renew its efforts toward implementation. During the monthly meeting of the Board of Trustees dated August 17, 2017, the Board of Trustees approved Group Administrators to administer the Health Reimbursement Account (HRA) option for participating retirees.

Contact Information

This financial report is designed to provide the employer, plan participants, and others with a general overview of the Plan's finances and to show accountability for the monies received. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Mr. John V. Kallianis
Executive Director
Retiree Health Care Trust
55 West Monroe Street, Suite 1950
Chicago, Illinois 60603

RETIREE HEALTH CARE PLAN
 Statements of Plan Net Position
 As of December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Investments, at fair value	\$ 759,399,348	\$ 724,315,680
<i>Receivables</i>		
Employee contributions receivable	15,164	8,023
Retiree contributions receivable	1,450,113	1,427,091
Accrued interest and dividends	1,592,882	1,793,925
Securities sold but not received	3,429,539	1,924,181
Other receivables	352,504	191,180
Total receivables	<u>6,840,202</u>	<u>5,344,400</u>
Prepaid expense	229	1,290,768
Total assets	<u>766,239,779</u>	<u>730,950,848</u>
LIABILITIES		
Accounts payable	3,675,041	3,877,787
Securities purchased but not paid	11,991,599	10,116,959
Total liabilities	<u>15,666,640</u>	<u>13,994,746</u>
Plan net position held in trust for other post-employment benefits	<u>\$ 750,573,139</u>	<u>\$ 716,956,102</u>

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

RETIREE HEALTH CARE PLAN
 Statements of Changes in Plan Net Position
 For the Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ADDITIONS		
<i>Contributions</i>		
Employee contributions	\$ 21,037,631	\$ 20,681,831
Retiree contributions	18,607,423	18,533,549
Rebates and reimbursements related to claims	752,266	537,682
Total contributions	<u>40,397,320</u>	<u>39,753,062</u>
<i>Investment income</i>		
Net appreciation (depreciation) in fair value of investments	29,448,997	(17,963,425)
Interest	10,736,065	10,093,735
Dividends	7,289,574	6,557,691
Net investment income before investment activity expenses	<u>47,474,636</u>	<u>(1,311,999)</u>
<i>Investment activity expenses</i>		
Investment management fees	(3,000,678)	(2,834,241)
Investment consulting fees	(165,000)	(165,000)
Custodian fees	(166,918)	(107,835)
Reporting, monitoring and other investment fees	(76,398)	(111,728)
Total investment activity expenses	<u>(3,408,994)</u>	<u>(3,218,804)</u>
Net investment income (loss)	<u>44,065,642</u>	<u>(4,530,803)</u>
Total additions	<u>84,462,962</u>	<u>35,222,259</u>
DEDUCTIONS		
Medical claims paid to providers	17,960,729	18,193,994
Medical premium payments to insurance companies	28,081,953	27,828,071
Dental premium payments to insurance companies	2,123,897	1,981,043
Claim administration fees	1,291,307	1,287,322
	<u>49,457,886</u>	<u>49,290,430</u>
Administrative expenses	1,388,039	1,575,432
Total deductions	<u>50,845,925</u>	<u>50,865,862</u>
Net increase (decrease)	33,617,037	(15,643,603)
Net position held in trust for other post-employment benefits		
Beginning of year	<u>716,956,102</u>	<u>732,599,705</u>
End of year	<u>\$ 750,573,139</u>	<u>\$ 716,956,102</u>

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

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 1 **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Reporting Entity

Pursuant to 40 ILCS 5/22-101B, as amended by Public Act 095-0708 on January 18, 2008, the Chicago Transit Authority (CTA) established the Retiree Health Care Trust (RHCT) and Plan, effective May 12, 2008. The primary responsibility of the RHCT is to provide funding to the Retiree Health Care Plan (the Plan), which provides and administers health care benefits to CTA's retirees and their dependents and survivors. The financial information of the Trust is incorporated into the Plan's financial statements.

CTA intends for the RHCT to satisfy the requirements of Section 115 of the Internal Revenue Code of 1986 (the Code), as amended. A private letter ruling regarding the exclusion of the RHCT's income from gross income under Section 115 was received from the Internal Revenue Service (IRS).

Under Public Act 095-0708 (the Act), Section 22-101B, after the establishment of the RHCT and starting January 1, 2009, and not later than July 1, 2009, the CTA no longer has any obligation to provide health care benefits to current or future retirees and their dependents or survivors. The retiree health care benefits are provided by the Retiree Health Care Plan.

Accounting principles generally accepted in the United States of America (U.S. GAAP) as established by the GASB define a financial reporting entity as consisting of the primary government and its component units for which the primary government is financially accountable. Financial accountability includes appointing a voting majority of a component unit's governing board, the ability of the primary government to impose its will on the component unit or the potential for the component unit to provide specific financial benefits to, or to impose specific financial burdens on, the primary government. A primary government may also be financially accountable for its component units that are fiscally dependent on it.

Based on the above criteria, the RHCT and Plan have no component units and are not a component unit of another entity.

Basis of Accounting

The Plan's financial statements are prepared on the accrual basis of accounting. Employee and retiree contributions are recognized when due. Benefits are recognized as deductions when paid; expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts and the Plan's net position at the date of the financial statements, the funded status of the Plan, the actuarial information included in the required supplementary information as of the actuarial valuation date, the changes in the Plan's net position during the reporting period, and disclosures of contingent assets and liabilities at the date of the financial statements. Accordingly, actual results may differ from those estimates.

Investments

The Plan is authorized to invest in bonds, notes, and other direct obligations of the U.S. government and U.S. government agencies; certain common stocks, and convertible bonds of U.S. companies; equity securities of foreign companies that trade in the U.S. financial markets through American Depositary Receipts (ADR); short-term investment funds; commingled funds composed of guaranteed investment contracts, bank investment contracts, and other stable value instruments; mortgage securities, venture capital, and partnerships.

The Plan does not have a formal investment risk policy. Investment risk management is a function of the Plan's asset allocation process. Plan assets are diversified over a broad range of asset classes, utilizing multiple investment strategies to limit concentration risk.

Method Used to Value Investments

To the extent available, investments are recorded at fair value based on quoted market prices in active markets on a trade-date basis. Additional information regarding the fair value measurement of investments is disclosed in Note 6. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net appreciation (depreciation) in the fair value of investments is recognized as a component of investment income.

Investments are reported at fair value. Short-term investments are reported at amortized cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Fixed-income securities are valued principally using quoted market prices provided by independent pricing services. For collective investments, the net asset value (NAV) is determined and certified by the investment managers as of the reporting date. Venture capital and partnerships do not have established market prices and are reported at estimated NAV by money managers. The pooled real estate investment funds are reported at NAV of shares held by the Plan at year end based on independent appraisals of underlying properties.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 1 **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(continued)*

Security Transactions

Purchases and sales of securities are accounted for on the trade-date basis. For purposes of determining the realized gain or loss on the disposal of investments, the average cost of investments sold is used. Unrealized gains or losses on investments held during the year, as well as realized gains or losses on securities sold, are included in the statement of changes in Plan net position in the period in which they occur.

Investment Income

Interest income is recognized on an accrual basis when earned. Dividend income is recognized on the ex-dividend date.

Furniture and Office Equipment

Furniture and office equipment are not capitalized, as they are immaterial and are charged to expenses in the period of purchase.

Administrative Expenses

Administrative expenses are recorded as incurred and budgeted and approved by the RHCT's Board of Trustees. Administrative expenses are paid from the Plan's assets and investment earnings. Certain administrative expenses are allocated between the Retirement Plan for CTA employees and the Retiree Health Care Plan based on periodic time and expense studies.

Recently Issued Accounting Pronouncements

In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application*. The objective of this Statement is to improve financial reporting by clarifying the definition of fair value for financial reporting purposes, establishing general principles for measuring fair value, providing additional fair value application guidance, and enhancing disclosures about fair value measurements. This Statement is effective for the periods beginning after June 15, 2015. The Plan adopted this statement with its year ending December 31, 2016. Adoption of this statement resulted in presentation changes to the financial statements and revised disclosures related to the financial statements.

In June 2015, the GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This Statement replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Recently Issued Accounting Pronouncements *(continued)*

It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, and Statement No. 50, *Pension Disclosures*. Statement No. 74 requires defined benefit OPEB plans to issue a statement of fiduciary net position and a statement of changes in fiduciary net position. This Statement improves financial reporting of OPEB plans through enhanced note disclosures and schedules of required supplementary information about the components of the net OPEB liability and related ratios, the OPEB plan's fiduciary net position as a percentage of the total OPEB liability and significant assumptions and other inputs used to measure the total OPEB liability as well as the sensitivity of the net OPEB liability to changes in the discount rate and healthcare cost trend rate. In addition, all defined benefit OPEB plans are required to present the annual money-weighted rate of return on OPEB plan investments for each of the most recent 10 fiscal years in the required supplementary information. Statement No. 74 is effective for fiscal years beginning after June 15, 2016. Early application is encouraged. Management has not determined the impact this GASB Statement will have on its financial statements.

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75). GASB 75 addresses employer and governmental non-employer contributing entities accounting and financial reporting when participating in an OPEB plan. This statement requires proper recognition of OPEB liabilities by employers and requires a more comprehensive measure of OPEB expense. More robust disclosures will also improve transparency and accountability. GASB 75 is effective for financial statements for the periods beginning after June 15, 2017. Early application is encouraged. The Plan does not expect GASB 75 to have a significant impact on the financial statements.

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB 76). GASB 76 identifies accounting sources used to prepare state and local government financial statements in conformity with GAAP, and established a GAAP hierarchy of these resources. This Statement improves financial reporting by raising the category of GAAP Implementation Guides in the GAAP hierarchy, by emphasizing the importance of analogies to authoritative literature when an accounting event is not specified in authoritative GAAP, and by requiring the consideration of consistency with GASB Concept Statements when evaluating accounting treatments in non-authoritative GAAP. The Plan adopted this statement with its year ending December 31, 2016. The adoption had no significant impact on the Plan's financial statements.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 1 **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(continued)*

Recently Issued Accounting Pronouncements *(continued)*

In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures* (GASB 77). GASB 77 provides financial reporting and disclosure guidance to governments that have either entered into tax abatement agreements or that have revenues affected by tax abatements entered into by another government. Governments will generally use tax abatements to encourage specific economic development that benefit either the government or its citizens by forgoing certain taxes. This statement is effective for reporting periods beginning after December 15, 2015. The Plan adopted this statement with its year ending December 31, 2016. The adoption had no significant impact on the Plan's financial statements.

In December 2015, the GASB issued Statement No. 79, *Certain Investment Pools and Pool and Pool Participants* (GASB 79). GASB 79 establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. Specific criteria address (1) the way the external investment pool transacts with participants; (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation and requirements of a shadow price. The Plan adopted this statement with its year ending December 31, 2016. The adoption had no significant impact on the Plan's financial statements.

NOTE 2 **PLAN DESCRIPTION AND CONTRIBUTION INFORMATION**

Plan and Trust Description

The following brief description of the Plan and RHCT is provided for general information purposes only. Participants should refer to the Plan and RHCT documents, as amended, for complete information.

The Plan is a single-employer, defined-benefit post-employment health care plan. The Plan provides medical, prescription drug, and dental benefits to eligible retirees and their dependents and survivors starting not later than July 1, 2009, but no earlier than January 1, 2009. Dental benefits prior to age 65 are also available at cost.

The RHCT and Plan are administered by a seven-member Board of Trustees composed of members appointed by the CTA, the Amalgamated Transit Union (ATU) and the Regional Transportation Authority. The Board of Trustees of the RHCT and Plan has the authority to establish or amend the contribution and benefit provisions under the Plan. The Plan is classified as a governmental plan and, therefore, is exempt from certain provisions of the Employee Retirement Income Security Act of 1974, as amended.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 2 PLAN DESCRIPTION AND CONTRIBUTION INFORMATION *(continued)*

Plan and Trust Description *(continued)*

The Act, enacted on January 18, 2008, provides funding for the retiree health care benefits and makes substantive changes to the retirees' health care benefits. Under the Act, CTA issued pension obligation bonds and deposited approximately \$528,800,000 into the RHCT in August 2008. Funding for retiree health care benefits comes from employees' contributions, retirees' contributions, and investment earnings in the RHCT.

The RHCT was required to assume financial responsibility for retiree health care benefits no later than July 1, 2009, and the CTA has no further responsibility to fund the retiree health care costs. The Board of Trustees of the RHCT is required by the Act to make an annual assessment of the funding levels of the RHCT and has the authority to increase members' contributions, decrease benefits, or a combination of both, to eliminate any funding shortfall within 10 years.

Major changes to the Plan's benefits under the Act include the following:

- All active CTA employees are required to contribute 3% of their compensation to the RHCT. This rate is subject to change every year and it is subject to a 45% test according to Section 22-101B (b)(5) of the Illinois Pension Code. Total contributions from members taken together cannot exceed 45% of total retiree health care costs in the prior plan year.
- Beginning July 1, 2009, retirees were required to make contributions for their health care coverage.
- To be eligible for retiree health care benefits, the Act requires that a CTA employee must be at least 55 years old and have at least 10 continuous years of service if he or she retires after January 18, 2008. The Board of Trustees increased the minimum number of years required to get health care benefits to 20 years. As a result, to be eligible for retiree health care benefits, a CTA employee must be at least 55 years old and have at least 20 years of service.

However, participants are entitled to health care benefits from the Plan if years of service are equal to or higher than 25 if they were hired prior to September 5, 2001, regardless of age, as long as retirement occurs prior to the full execution of the next collective bargaining agreement (CBA) between CTA and Locals 241 and 308 of the Amalgamated Transit Union. The current CBA expired on December 31, 2015. However, the terms and conditions remain in effect pending execution of a new CBA.

- Effective January 1, 2013, the Plan changed its benefits for participants who are eligible for Medicare by providing two new Medicare Advantage benefit options to them. For additional information regarding benefits, coverage, services and deductible, please refer to the enrollment guide.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 2 PLAN DESCRIPTION AND CONTRIBUTION INFORMATION *(continued)*

Membership

At December 31, 2016 and 2015, the number of participants* was as follows:

	<u>2016</u>	<u>2015</u>
Retirees and beneficiaries receiving benefits	8,795	8,944
Terminated plan members entitled to but not yet receiving benefits	108	115
Active participants	<u>10,329</u>	<u>10,234</u>
	<u>19,232</u>	<u>19,293</u>

* Number of participants above do not include separated participants eligible for HRA, 4,903 eligible participants for 2016 and 4,203 eligible participants for 2015.

Contributions

During 2016 and 2015, retiree health care benefits were funded through active employee contributions, retiree contributions, investment return on assets, rebates, and other reimbursements.

The Act, 095-0708, effective January 18, 2008, authorized the CTA to issue bonds and notes in the aggregate amount of \$639,680,000, of which net proceeds of \$528,800,000 were deposited into the RHCT in August 2008 as advance funding.

During 2016 and 2015, active employees were required to contribute 3% of their salary to the RHCT.

Funded Status and Funding Progress

According to the Act, the Plan should maintain an appropriate funding reserve level that should not be less than the amount of incurred and unreported claims plus 12 months of expected claims and administrative expenses. An annual assessment of the funding level is required to be submitted to the Auditor General at least 90 days prior to the end of the fiscal year.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment and mortality and the health care cost trend. Amounts determined regarding the funded status of the Plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 2 PLAN DESCRIPTION AND CONTRIBUTION INFORMATION *(continued)*Funded Status and Funding Progress *(continued)*

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The funded status of the Plan as of December 31, 2016 and 2015 was as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Projected-Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/16	\$750,573,139	\$576,423,654	\$(174,149,485)	130.2%	\$666,313,894	(26.1)%
12/31/15	\$716,956,102	\$546,751,665	\$(170,204,437)	131.1%	\$662,684,711	(25.7)%

The actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Because actuarial calculations reflect a long-term perspective, actuarially determined amounts are subject to continual revision, as results are compared to past expectations and new estimates made about the future. Examples include assumptions about mortality, investment returns and healthcare cost trends. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents information about whether the actuarial values of Plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 2 PLAN DESCRIPTION AND CONTRIBUTION INFORMATION *(continued)*

Funded Status and Funding Progress *(continued)*

Additional information as of the latest actuarial valuation follows:

Valuation date:	December 31, 2016 and 2015
Actuarial cost method:	Projected-unit credit
Amortization method:	Level dollar, open
Remaining amortization period:	30 years
Asset valuation method:	Market value
<i>Actuarial assumptions</i>	
Investment rate of return:	7.00% for 2016 and 2015
Projected salary increases:	For 2016 and 2015 valuations: 9% for 1 year of service, 11% for 2 years of service, 16% for 3 years of service, 5% for 4 years of service, and 4% thereafter
Inflation rate	3.25% for 2016 and 2015
Medical and prescription drug cost trend rate:	For 2016 valuation: HMO and PPO (pre-Medicare) – 7.75% for 2017, graded to 4.5% over 13 years; MAPD (Medicare) – 10.0% for 2017, then 8.2% graded down to 4.5% over 13 years For 2015 valuation: HMO and PPO (pre-Medicare) – 7.7% for 2016, graded to 5% over 8 years; MAPD (Medicare) – 0.0% for 2016, then 8.25% graded to 5% over 7 years, with an additional 10% in 2017 for MAPD renewal

NOTE 3 INVESTMENT POLICY

The primary objective of the Plan’s investment policy is to provide a structured approach in implementing its investment strategies to achieve above-average returns consistent with prudent risk and investment volatility.

The Plan’s investment policy takes a long-term investment perspective by allocating its assets across major asset classes and diversified broadly within each asset class in accordance with the “prudent person rule” as prescribed by the Illinois Statutes. The target asset allocation is 60% total equities and 40% total fixed income, with periodic rebalancing when the allocations approach plus or minus 5% of the target allocations. This asset allocation is designed to provide a high likelihood of achieving a long-term rate of return of 7.25% per year.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 4 INVESTMENT SUMMARY

The Plan's investments were held by Northern Trust Company as custodian to the Plan.

The following table summarizes the Plan's investments by type at December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Asset-backed securities	\$ 5,606,887	\$ 9,278,939
Commercial mortgage-backed securities	1,082,507	3,215,471
Corporate bonds	128,694,426	113,699,159
Government agency securities	10,420,510	19,619,577
Government bonds	55,350,244	56,646,661
Government-issued commercial mortgage-backed securities	18,172	586,778
Government mortgage-backed securities	51,868,588	64,496,186
Municipal/provincial bonds	4,164,705	4,164,705
Non-government-backed CMOs	3,121,228	4,632,188
Index-linked government bonds	1,643,698	3,939,718
Opportunistic core bonds	15,907,363	18,827,694
U.S. equities	268,381,773	285,226,251
Foreign equities	108,603,245	81,701,625
Real estate	78,886,623	38,024,297
Short-term investments and currency positions	<u>25,649,379</u>	<u>20,256,431</u>
Total investments, at fair value	<u>\$ 759,399,348</u>	<u>\$ 724,315,680</u>

NOTE 5 INVESTMENT RISK

The Plan's investments are subject to risks, including stable NAV risk, credit risk, custodial credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. The following is a description of those risks:

Stable NAV Risk: The risk that the collective short-term investment fund will not be able to maintain a NAV per share of \$1.00 at all times. The investment advisor manages this risk by buying securities with remaining maturities of one year or less and investing only in U.S. dollar-denominated securities that represent minimal credit risks.

Credit Risk: Credit risk is the risk that an issuer of fixed-income securities held by the Plan may default on its obligation to pay interest and repay principal. This credit risk is measured by the credit quality ratings issued by a Nationally Recognized Statistical Rating Organization (NRSRO), such as Moody's and Standard & Poor's. The Plan has no formal credit risk policy. The Plan limits its investments to securities that have short-term debt ratings at the time of purchase in the two highest rating categories of a NRSRO or that are issued or guaranteed by, or otherwise allow the Plan to demand payment from, an issuer with such ratings.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 5 INVESTMENT RISK (continued)

The following tables provide information on the credit ratings associated with the Plan's investments in debt securities at December 31, 2016 and 2015. Rates were obtained from Standard & Poor's.

	2016					
	Asset-Backed Securities	Commercial Mortgage-Backed Securities	Corporate Bonds	Government Agency Securities	Government Bonds	Government-Issued CMOs
'AAA'	\$ 857,166	\$ 488,348	\$ 878,469	\$ -	\$ -	\$ -
'AA'	1,893,492	182,089	6,896,944	10,420,510	-	-
'A'	110,457	-	16,900,492	-	-	-
'BBB'	348,881	-	30,720,034	-	213,469	-
'BB'	-	-	6,591,792	-	-	-
'B'	-	-	1,337,550	-	-	-
'CCC'	-	-	-	-	-	-
'CC'	-	-	-	-	-	-
'D'	-	-	-	-	-	-
Not rated	2,396,891	412,070	65,369,145	-	-	-
U.S. Govt. agencies	-	-	-	-	55,136,775	18,172
Total	\$ 5,606,887	\$ 1,082,507	\$ 128,694,426	\$ 10,420,510	\$ 55,350,244	\$ 18,172

	2016 (continued)					
	Government Mortgage-Backed Securities	Municipal/Provincial Bonds	Non-Government-Backed CMOs	Index-Linked Government Bonds	Opportunistic Core Bonds	Total
'AAA'	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,223,983
'AA'	175,603	-	-	-	-	19,568,638
'A'	-	-	308,570	-	-	17,319,519
'BBB'	-	-	292,248	-	-	31,574,632
'BB'	-	-	-	-	-	6,591,792
'B'	-	-	468,584	-	-	1,806,134
'CCC'	-	-	233,847	-	-	233,847
'CC'	-	-	-	-	-	-
'D'	-	-	-	-	-	-
Not rated	2,612,025	4,164,705	1,817,979	-	15,907,363	92,680,178
U.S. Govt. agencies	49,080,960	-	-	1,643,698	-	105,879,605
Total	\$ 51,868,588	\$ 4,164,705	\$ 3,121,228	\$ 1,643,698	\$ 15,907,363	\$ 277,878,328

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 5 INVESTMENT RISK (continued)

Credit Risks (continued)

	2015					
	Asset- Backed Securities	Commercial Mortgage-Backed Securities	Corporate Bonds	Government Agency Securities	Government Bonds	Commercial Mortgage- Backed Securities
'AAA'	\$ 2,148,683	\$ 1,176,127	\$ 1,555,207	\$ -	\$ -	\$ -
'AA'	2,828,789	250,942	5,198,177	19,619,577	-	-
'A'	129,857	556,586	9,346,857	-	-	-
'BBB'	423,629	-	22,560,128	-	-	-
'BB'	-	-	6,411,743	-	-	-
'B'	-	-	1,803,063	-	-	-
'CCC'	-	-	152,950	-	-	-
'CC'	-	-	-	-	-	-
'D'	-	-	-	-	-	-
Not rated	3,747,981	1,231,816	66,671,034	-	-	-
U.S. Govt. agencies	-	-	-	-	56,646,661	586,778
Total	\$ 9,278,939	\$ 3,215,471	\$ 113,699,159	\$ 19,619,577	\$ 56,646,661	\$ 586,778

	2015 (continued)					
	Government Mortgage- Backed Securities	Municipal/ Provincial Bonds	Non- Government- Backed CMOs	Index- Linked Government Bonds	Opportunistic Core Bonds	Total
'AAA'	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,880,017
'AA'	539,857	-	-	-	-	28,437,342
'A'	-	-	403,835	-	-	10,437,135
'BBB'	-	-	348,094	-	-	23,331,851
'BB'	-	-	-	-	-	6,411,743
'B'	-	-	580,217	-	-	2,383,280
'CCC'	-	-	311,998	-	-	464,948
'CC'	-	-	-	-	-	-
'D'	-	-	219,639	-	-	219,639
Not rated	2,710,113	4,164,705	2,768,405	-	18,827,694	100,121,748
U.S. Govt. agencies	61,246,216	-	-	3,939,718	-	122,419,373
Total	\$ 64,496,186	\$ 4,164,705	\$ 4,632,188	\$ 3,939,718	\$ 18,827,694	\$ 299,107,076

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 5 INVESTMENT RISK *(continued)*

Custodial Credit Risk: For an investment, it is the risk that, in the event of the failure of the counterparty to a transaction, the Plan will not be able to recover the value of 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. The Plan's master custodian holds all investments of the Plan in the Plan's name. At December 31, 2016 and 2015, deposits of approximately \$7,873 and \$0, respectively, were exposed to custodial credit risk as uninsured and uncollateralized.

Concentration of Credit Risk: The concentration of credit risk is the risk of loss attributed to the magnitude of a Plan's investment in a single issuer.

The following investments represented 5% or more of the Plan's net position at December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Institutional Emerging Markets Debt Fund	\$ 42,302,457	\$ 36,346,945
NT S&P 400 Index – Lending Fund	44,054,933	52,012,596
NT S&P 500 Equity Index – Lending Fund	58,139,583	54,596,214
Clarion Lion Properties Fund LLC	40,757,707	37,500,000
Heitman America Real Estate Trust	38,128,916	(a)

(a)–New investment in 2016.

The Plan did not invest in derivative instruments during the years ended December 31, 2016 and 2015.

Interest Rate Risk: The risk that during periods of rising interest rates, the fixed-income investments' yield will be lower than prevailing market rates; in periods of falling interest rates, the fixed-income investments' yield will tend to be higher. All fixed-income investments are managed by external investment managers. Each investment manager is required to determine the maturities of all fixed-income securities in their portfolio. Additionally, guidelines are provided to the external investment managers, given the level of risk within the investment manager's portfolio. These guidelines include a target duration range that is consistent with each investment manager's respective strategy.

The following tables segment the distribution of the Plan's investments into time periods of maturities based on the investments' cash flows.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 5 INVESTMENT RISK (continued)

Interest Rate Risk (continued)

At December 31, 2016, the Plan had the following investments and maturities related to certain fixed-income securities:

Investment Type	Market Value	Investment Maturities					Maturity Not Determined
		Less Than 1 Year	1+ to 6 Years	6+ to 10 Years	More Than 10 Years		
Asset-backed securities	\$ 5,606,887	\$ -	\$ 12,606	\$ 308,778	\$ 5,285,503	\$ -	
Commercial mortgage-backed securities	1,082,507	-	-	-	1,082,507	-	
Corporate bonds	128,694,426	1,543,300	25,568,374	29,064,291	8,029,606	64,488,855	
Government agency securities	10,420,510	212,336	10,208,174	-	-	-	
Government bonds	55,350,244	-	20,051,396	6,648,367	28,650,481	-	
Government-issued commercial mortgage-backed securities	18,172	-	-	-	18,172	-	
Government mortgage-backed securities	51,868,588	175,603	3,531,789	14,270,985	28,678,094	5,212,117	
Municipal/provincial bonds	4,164,705	-	-	4,164,705	-	-	
Non-government-backed collateralized mortgage obligations	3,121,228	-	141,234	-	2,979,994	-	
Index-linked government bonds	1,643,698	-	-	875,848	767,850	-	
Opportunistic core bonds	15,907,363	-	-	-	-	15,907,363	
Total	\$ 277,878,328	\$ 1,931,239	\$ 59,513,573	\$ 55,332,974	\$ 75,492,207	\$ 85,608,335	

At December 31, 2015, the Plan had the following investments and maturities related to certain fixed-income securities:

Investment Type	Market Value	Investment Maturities					Maturity Not Determined
		Less Than 1 Year	1+ to 6 Years	6+ to 10 Years	More Than 10 Years		
Asset-backed securities	\$ 9,278,939	\$ -	\$ 1,035,172	\$ 1,441,303	\$ 6,802,464	\$ -	
Commercial mortgage-backed securities	3,215,471	-	209,412	-	3,006,059	-	
Corporate bonds	113,699,159	3,168,023	16,945,345	19,683,022	8,056,015	65,846,754	
Government agency securities	19,619,577	-	19,619,577	-	-	-	
Government bonds	56,646,661	-	19,823,174	8,919,263	27,904,224	-	
Government-issued commercial mortgage-backed securities	586,778	-	409,170	-	177,608	-	
Government mortgage-backed securities	64,496,186	-	5,198,676	13,801,076	37,786,746	7,709,688	
Municipal/provincial bonds	4,164,705	-	-	4,164,705	-	-	
Non-government-backed collateralized mortgage obligations	4,632,188	-	-	219,639	4,412,549	-	
Index-linked government bonds	3,939,718	-	381,452	1,633,726	1,924,540	-	
Opportunistic core bonds	18,827,694	-	-	-	-	18,827,694	
Total	\$ 299,107,076	\$ 3,168,023	\$ 63,621,978	\$ 49,862,734	\$ 90,070,205	\$ 92,384,136	

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 5 INVESTMENT RISK *(continued)*

Foreign Currency Risk: The risk that changes in exchange rates will adversely affect the fair value of an investment. International equity securities purchased by the Plan meet exchange listing requirements and all foreign equities held by the Plan are denominated in U.S. dollars. The Plan has no formal foreign currency risk policy. The Plan's exposure to foreign currency risk is as follows:

<u>Type of investment</u>	<u>(US\$)</u> <u>2016</u>	<u>(US\$)</u> <u>2015</u>
<i>Short-term investment and currency positions</i>		
Indian rupee	\$ 24,170	\$ -
<i>Equities</i>		
Australian dollar	\$ 801,338	\$ 2,719,067
Brazilian real	2,396,320	-
British pound sterling	7,343,301	16,149,617
Canadian dollar	1,820,647	2,309,588
Danish krone	441,721	2,402,719
European euro	7,344,137	19,927,875
Hong Kong dollar	2,896,784	379,098
Hungarian forint	235,449	-
Indonesian rupiah	1,311,538	-
Indian rupee	2,069,824	-
Japanese yen	5,621,897	14,795,889
Malaysian ringgit	287,492	-
Mexican peso	384,002	-
New Taiwan dollar	740,054	-
Norwegian krone	817,414	1,173,553
Philippine peso	121,127	-
Singapore dollar	-	949,153
South African rand	1,435,413	-
South Korean won	2,400,611	811,278
Swedish krona	1,128,976	2,307,998
Swiss franc	1,185,629	2,845,456
Thai baht	689,404	-
Turkish lira	260,649	-
United Arab Emirates dirham	99,667	-
	<u>\$41,833,394</u>	<u>\$66,771,291</u>

Investment management fees from equity and fixed-income managers, including most of the collective funds, are included in the investment management fees on the statement of changes in Plan net position. Investment management fees from funds of short-term investments and private equity are reflected in the net investment income from such investment products. Such investment management fees are not significant to the financial statements.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 6 FAIR VALUE OF INVESTMENTS

GASB 72, *Fair Value Measurements and Application*, clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value measurements. GASB 72 established a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liabilities as of the measurement date. The three levels are defined as follows:

- Level 1:* Observable market inputs that are unadjusted quoted prices for identical assets or liabilities in active markets that a government can access at the measurement date.
- Level 2:* Inputs other than quoted prices included within Level 1 – that are observable for the asset or liability, either directly or indirectly.
- Level 3:* Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 6 FAIR VALUE OF INVESTMENTS *(continued)*

The Plan categorized its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The Plan has the following recurring fair value measurements as of December 31, 2016:

	12/31/2016	Fair Value Measurements Using		
		Quoted Prices in Active Markets or Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level				
<i>Fixed income investments</i>				
Asset-backed securities	\$ 5,606,887	\$ -	\$ 5,606,887	\$ -
Commercial mortgage-backed securities	1,082,507	-	1,082,507	-
Corporate bonds	64,205,571	-	64,205,571	-
Government agency securities	10,420,510	-	10,420,510	-
Government bonds	56,993,942	-	56,993,942	-
Government-issued commercial mortgage-backed securities	18,172	-	18,172	-
Government mortgage-backed securities	51,868,588	-	51,868,588	-
Municipal/provincial bonds	4,164,705	-	4,164,705	-
Non-government-backed CMOs	3,121,228	-	3,121,228	-
Total fixed income investments	197,482,110	-	197,482,110	-
<i>Equity investments</i>				
Corporate stocks	318,499,339	216,304,823	102,194,516	-
<i>Investments measured at net asset value (NAV)</i>				
International bond fund	22,186,398			
Emerging makets debt fund	42,302,457			
Opportunistic core bonds plus fund	15,907,363			
Emerging markets small-cap fund	13,471,058			
International small-cap fund	35,316,812			
Emerging markets instl fund	9,697,809			
Real estate open fund	78,886,623			
Total investments measured at NAV	217,768,520			
Total investments by fair value level	\$ 733,749,969			
<i>Investments not subject to fair value leveling (at cost or amortized cost)</i>				
Short-term inv and currency positions	\$ 25,649,379			

Equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

Equity funds and fixed income securities classified in Level 2 of the fair market hierarchy are valued using either a bid evaluation or a matrix pricing technique maintained by various pricing vendors. Bid evaluations may include market quotations, yields, maturities, call features and ratings. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

RETIREE HEALTH CARE PLAN
Notes to Financial Statements
December 31, 2016 and 2015

NOTE 6 FAIR VALUE OF INVESTMENTS *(continued)*

The redemption restrictions for investments measured at the NAV per share (or its equivalent) is presented on the following table:

<u>Investments Measured at NAV</u>	<u>Fair Value</u>	<u>Redemption Frequency (if Current Eligible)</u>	<u>Redemption Notice Period</u>
International bond fund	\$ 22,186,398	Monthly	10 days
Emerging markets debt fund	42,302,457	Monthly	5 days
Opportunistic core plus fund	15,907,363	Daily	1 to 3 days
Emerging markets small-cap fund	13,471,058	Monthly	1 to 15 days
International small-cap fund	35,316,812	Monthly	1 to 15 days
Emerging markets instl fund	9,697,809	Daily	1 to 3 days
Real estate open fund	<u>78,886,623</u>	Quarterly	90 days
Total investments measured at NAV	<u>\$ 217,768,520</u>		

International bond fund. This fund invest principally in debt securities, including obligations of foreign government or corporate entities or supranational agencies (such as the World Bank) denominated in various currencies. The fair value in this type of investment has been determined using the NAV per unit of the Fund and is calculated on each business day by dividing the total value of assets, less liabilities, by the number of units of beneficial ownership outstanding.

Emerging markets debt fund. This Fund invest primarily in a diversified portfolio of fixed-income securities issued by entities whose principal domicile is in an emerging-market country. The value of each unit of participation is determined daily and it is calculated by dividing the total value of assets, less liabilities, by the number of units outstanding.

Opportunistic core plus fund. This type includes investments in commingled investment entities such as open-ended limited partnerships and registered or unregistered investment companies maintained or offered by the investment manager or any affiliate of the investment manager. Any assets of the account which are held in any Fund will be redeemed only at such time as permitted by the applicable Governing Documents of such Funds. The NAV of each Fund's shares is determined by dividing the net assets attributable to each class of shares of the Fund by the number of issued and outstanding shares of the Class/Fund on each business day.

Emerging markets small-cap fund. This Fund invests in markets which are developing. It may invest directly or indirectly in securities and other instruments, including in other pooled investment vehicles sponsored or managed by the investment manager or, otherwise affiliated with the investment manager. The per unit net asset value of the Fund is determined each business day.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 6 FAIR VALUE OF INVESTMENTS *(continued)*

International small-cap fund. This fund invests in international small-cap securities and the net asset value of its units is calculated at the end of the day each business day.

Emerging markets fund. This fund primarily invests in equity securities, principally common stocks, of non-US companies whose principal activities are located in emerging market countries that the manager believes are undervalued based on their earnings, cash flow and asset values. The net asset value per share is determined by dividing the value of the total assets of the portfolio represented by such class, less all liabilities, by the total number of portfolio shares of such class outstanding.

Real estate funds. This type consists of two core open-end real estate funds. Open-end funds provide liquidity to investors quarterly, subject to each fund's ability to honor investment and redemption requests. However, the funds will not be required to cause the Funds to sell any investments to satisfy redemption requests. Additionally, redemptions may be suspended at any given time by the Funds. The NAV per share on any given date is equal to the NAV on such date divided by the total number of outstanding interests on such date.

NOTE 7 UNFUNDED INVESTMENT COMMITMENTS

The Plan had unfunded commitments of approximately \$0 million at December 31, 2016 and \$37.5 million at December 31, 2015.

NOTE 8 RISKS AND UNCERTAINTIES

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

Contributions to the Plan and the actuarial information are reported based on certain assumptions pertaining to interest rates, health care inflation rates, and employee demographics, all of which are subject to change. Due to uncertainties inherent in the estimation and assumption processes, it is at least reasonably possible that changes in these estimates and assumptions in the near term could materially affect the amounts reported and disclosed in the financial statements.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 8 RISKS AND UNCERTAINTIES *(continued)*

The actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Because actuarial calculations reflect a long-term perspective, actuarially determined amounts are subject to continual revision, as results are compared to past expectations and new estimates made about the future. Examples include assumptions about mortality, investment returns, and future employment.

The Plan is subject to various claims and legal proceedings arising in the ordinary course of business which, in management's opinion, will be resolved without any material adverse effect on the Plan's financial position or changes in its financial position.

NOTE 9 LEGAL PROCEEDINGS

Matthews v. Chicago Transit Authority, et al., No. 11 CH 15446 (Circuit Court of Cook County, Illinois). On April 26, 2011, Plaintiffs Jerry Matthews, Jerry Williams, Tommy Sams, Cynthia Boyne and Charles Brown, all employees and retirees of the Chicago Transit Authority, filed suit against the CTA and against the Retirement Plan for Chicago Transit Authority Employees, the Board of Trustees of the Retirement Plan for Chicago Transit Authority Employees, the Retiree Health Care Trust, and the Board of Trustees of the Retiree Health Care Trust (collectively, the "Plan and Trust Defendants"). The claims were brought on behalf of two purported classes. Class I, consisted of CTA employees who retired before January 1, 2007; Class II consists of CTA employees who were currently employed by the CTA or retired after January 1, 2007.

Generally, the plaintiffs challenged the reduction of health care benefits for retirees in the 2007 Collective Bargaining Agreement (CBA) governing CTA employees, and the related provisions of 40 ILCS 5/22-101B, which require retirees to pay up to 45% of the cost of their health care benefits.

On May 5, 2016, the Illinois Supreme Court affirmed the appellate court's judgment in part and reversed in part. 2016 IL 117638. The Supreme Court determined that the Class II plaintiffs, the current employees and those that retired after January 1, 2007, lacked standing to challenge the 2007 CBA and affirmed the dismissal of all of their claims. The Supreme Court found that the Class I plaintiff, Jerry Williams, who retired prior to the expiration of the 2004 CBA had standing to challenge the modification to health care benefits pursuant to the 2007 CBA. The Supreme Court also found that the Class I plaintiff sufficiently stated a cause of action against the Plan and Trust Defendants for breach of contract, for declaratory judgment, and for violation of the pension protection clause because the 2004 CBA constituted an enforceable, vested right as to those who retired before the expiration of that agreement. Finally, the Supreme Court held that the retired employees were not entitled to pursue their claim of promissory estoppel against the CTA because they sought to enforce an obligation that went beyond the terms of the 2004 CBA. The Supreme Court remanded the case to the Circuit Court for further proceedings.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 9 **LEGAL PROCEEDINGS** *(continued)*

The case is now back in the Circuit Court. On May 31, 2017, Plaintiffs were granted leave to file a First Amended Complaint, which removed named plaintiffs whose claims were dismissed, removed the Chicago Transit Authority as a defendant, and largely removed dismissed claims. The First Amended Complaint lists Jerry Williams as the first named plaintiff, and adds two retiree named plaintiffs, Stewart Cooke and Larry Whitehead. The case is now captioned *Williams et al. v. Retirement Plan for Chicago Transit Authority Employees, et al.*

The Retirement Plan for Chicago Transit Authority Employees and the Board of Trustees of the Retirement Plan for Chicago Transit Authority Employees filed a motion to dismiss a portion of the First Amended Complaint, specifically the allegations challenging the composition of the Retirement Plan Board, and answered the remaining counts. The Retiree Health Care Trust and the Board of Trustees of the Retiree Health Care Trust Defendants also filed a motion to dismiss the First Amended Complaint for failure to state a claim. Defendants' motions to dismiss are being briefed, no hearing date has been set. The parties are engaged in discovery. The Retiree Healthcare Trust is vigorously defending the matter. At this time, management is unable to determine the amount or range of any potential loss in the event of an unfavorable outcome.

NOTE 10 **OPERATING LEASE**

During 2013, the Retirement Plan for CTA employees entered into a new lease agreement for office space. The lease expires on December 31, 2028. Rent paid by the Plan was \$34,719 in 2016 and \$31,975 in 2015, which represents 25% of the total amount of rent paid for the shared office facility. The remaining 75% of rent due was paid by the Retirement Plan for CTA employees based on management's expense allocation for the shared office space.

NOTE 11 **TAX STATUS**

The IRS issued a private letter ruling dated June 16, 2009, stating that the RHCT is qualified under Section 115(1) of the Code and, therefore, the RHCT's income is excludable from gross income. The RHCT and the Plan are required to operate in conformity with the Code to maintain this tax-exempt qualification. The Plan's management is not aware of any course of action or series of events that have occurred that may adversely affect the RHCT and the Plan's tax status.

RETIREE HEALTH CARE PLAN

Notes to Financial Statements

December 31, 2016 and 2015

NOTE 12 SUBSEQUENT EVENTS

During the monthly meeting of the Board of Trustees dated April 27, 2017, the eligibility for retiree health care coverage was changed. Effective January 1, 2018, participants would become eligible to receive health care benefits if they meet the following criteria (1) they separate from service at or after age 55 with at least 20 years of eligibility service, or (2) they separate with at least 10 years of service and are at least age 65 at the time they enroll.

During the monthly meeting of the Board of Trustees dated March 31, 2017, the Board had expressed the desire to move forward with the implementation of a health reimbursement arrangement and directed the General Administration Committee of the Board of Trustees to renew its efforts towards implementation. During the monthly meeting of the Board of Trustees dated August 17, 2017, the Board of Trustees approved Group Administrators to administer the Health Reimbursement Account (HRA) option for participating retirees.

REQUIRED SUPPLEMENTARY INFORMATION

RETIREE HEALTH CARE PLAN
 Schedule of Funding Progress
 (Unaudited)

<u>Year</u>	<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Projected Unit Credit (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a Percentage of Covered Payroll (b-a)/c</u>
2016	12/31/2016	\$750,573,139	\$576,423,654	\$(174,149,485)	130.2%	\$666,313,894	(26.1)%
2015	12/31/2015	716,956,102	546,751,665	(170,204,437)	131.1	662,684,711	(25.7)
2014	12/31/2014	732,599,705	546,685,683	(185,914,022)	134.0	632,394,411	(29.4)

See accompanying Independent Auditor's Report.

RETIREE HEALTH CARE PLANSchedule of Contributions from Employer and Other Contributing Entities
(Unaudited)

<u>Year Ended December 31</u>	<u>Annual Required Contributions</u>	<u>Actual Contributions</u>	<u>Percentage Contributed</u>
2016	\$ -	\$ -	N/A
2015	-	-	N/A
2014	-	-	N/A

N/A—Not applicable.

See accompanying Independent Auditor's Report.

RETIREE HEALTH CARE PLAN

Notes to Required Supplementary Information
For the Years Ended December 31, 2016 and 2015
(Unaudited)

Actuarial Method and Assumptions

The information presented in the required supplementary schedules was determined as part of the actuarial valuation as of the date indicated. Additional information as of the latest actuarial valuation follows:

Valuation date:	December 31, 2016 and 2015
Actuarial cost method:	Projected-unit credit
Amortization method:	Level dollar, open
Amortization period:	30 years remaining
Asset valuation method:	Market value
<i>Actuarial assumptions</i>	
Investment rate of return:	7.00% for 2016 and 2015
Projected salary increases:	For 2016 and 2015 valuations: 9.0% for 1 year of service, 11% for 2 years of service, 16% for 3 years of service, 5% for 4 years of service, and 4% thereafter
Inflation rate:	3.25% for 2016 and 2015
Medical and prescription drug cost trend rate:	For 2016 valuation: HMO & PPO (pre-Medicare) – 7.75% for 2017, graded to 4.5% over 13 years; MAPD (Medicare) – 10.0% for 2017, then 8.2% graded down to 4.5% over 13 years. For 2015 valuation: HMO & PPO (pre-Medicare) – 7.7% for 2016, graded to 5.0% over 8 years; MAPD (Medicare) – 0.0% for 2016, then 8.25% graded to 5.0% over 7 years, with an additional 10% in 2017 for MAPD renewal

See accompanying Independent Auditor's Report.

OTHER INFORMATION

RETIREE HEALTH CARE PLAN

Schedule of Investment and Administrative Expenses
For the Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
<i>Investment expenses</i>		
Investment management fees	\$ 3,000,678	\$ 2,834,241
Investment consulting fees	165,000	165,000
Custodian fees	166,918	107,835
Other investment fees	48,398	83,728
Reporting and monitoring	<u>28,000</u>	<u>28,000</u>
Total investment expenses	<u>\$ 3,408,994</u>	<u>\$ 3,218,804</u>
<i>Administrative expenses</i>		
Staff salaries and fringe benefits	\$ 356,049	\$ 363,450
Outside consultants	22,895	23,231
Actuarial services	172,722	214,345
Auditing	66,003	62,672
Legal fees	420,317	451,146
Legal research	-	2,321
Data processing	66,603	154,160
Court reporting	10,692	7,058
Stationery and printing	37,333	41,369
Telephone and communication	5,749	5,781
Postage and messenger	43,356	37,318
Office space	34,719	31,975
Supplies	4,883	4,474
Utilities	1,079	1,101
Equipment	5,517	5,139
Insurance	65,579	63,469
Travel and seminars	12,992	11,933
Seminars for retirees	4,679	5,010
PCORI fee	3,706	4,008
ACA transitional reinsurance fee	43,668	75,875
Forms submission	3,731	2,306
Miscellaneous	<u>5,767</u>	<u>7,291</u>
Total administrative expenses	<u>\$ 1,388,039</u>	<u>\$ 1,575,432</u>

See accompanying Independent Auditor's Report.

