

VLCT Property and Casualty Intermunicipal Fund, Inc.

Audited Financial Statements
with Supplementary Information

*Years ended December 31, 2012 and 2011
with Report of Independent Auditors*

VLCT Property and Casualty Intermunicipal Fund, Inc.

Audited Financial Statements
with Supplementary Information

Years ended December 31, 2012 and 2011

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Report of Independent Auditors

The Board of Directors
VLCT Property and Casualty Intermunicipal Fund, Inc.

We have audited the accompanying financial statements of VLCT Property and Casualty Intermunicipal Fund, Inc. ("the Fund"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of contributions, expenses, and changes in net position and cash flows 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of VLCT Property and Casualty Intermunicipal Fund, Inc. as of December 31, 2012 and 2011 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

The accounting principles generally accepted in the United States require that the Management's Discussion and Analysis on pages 4 - 20 and the accompanying financial information listed on pages 41 - 43 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 Information

Our audits were conducted for the purpose of forming an opinion on the Fund's basic audited financial statements. The other information on pages 44 - 46 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The other information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

A handwritten signature in cursive script that reads "Johnson Lambert LLP".

Burlington, Vermont
March 13, 2013

Vermont firm registration: 092-0000267

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis

December 31, 2012 and 2011

Management of the VLCT Property and Casualty Intermunicipal Fund, Inc., (the "Fund") presents the following overview and analysis of its financial operations for the fiscal year ended December 31, 2012, to be reviewed and considered in conjunction with the more detailed statements, schedules, exhibits and notes in the ensuing pages of this report.

Highlights

- Assets exceeded liabilities at the end of 2012 by \$24,218,087. Of this amount, \$23,018,087 is unrestricted, and \$1,200,000 has been restricted by the Board. The restricted amount represents \$1,000,000 of premium credits to be applied to 2013 and \$200,000 to fund the member safety grant program in 2013. The board has also designated \$1,339,360 for the safety margin by recommendation of the Fund's actuary in order to maintain a 90% confidence level in the adequacy of the non-case reserves (IBNR-incurred but not reported). The board designated amounts are included within unrestricted.
- In 2011, assets exceeded liabilities by \$26,771,878, of which \$25,271,878 was unrestricted as of the end of the year. In 2010, assets exceeded liabilities by \$24,063,888, of which \$23,063,888 was unrestricted as of the end of the year. Restricted funds for 2011 and 2010 were \$1,500,000 and \$1,000,000, respectively. Restricted net position for 2011 of \$1,500,000 consisted of \$1,250,000 of premium credits to be applied to 2012 and \$250,000 to fund the member safety grant program in 2012. Restricted net position of \$1,000,000 for 2010 consisted of \$800,000 of premium credits to be applied to 2011 and \$200,000 to fund the member safety grant program in 2011. The Board also designated \$1,045,499 and \$902,724 of unrestricted net position for the safety margin allocation for 2011 and 2010, respectively.
- Unrestricted net position in 2012 decreased by \$2,253,791 or 9% from 2011. The ratio of unrestricted net position to total assets decreased to 44% in 2012 from 53% in 2011, with an increase in assets of \$3,874,016 or 8% offset by a 30% increase in liabilities. By comparison, 2011 reflected an increase in assets of 9% combined with a 7% increase in liabilities, resulting in a slight increase in unrestricted net position ratio from 52.5% to 52.6%. The primary reason for the decrease during 2012 in unrestricted net position was adverse claim development for prior years. As of December 31, 2012, the change in net ultimate incurred losses (not including safety margin) is an increase of \$5,026,408. This is 6% of the total ultimate incurred (\$82,645,607 ultimate incurred estimated by the actuary). As of December 31, 2011, the change in net ultimate incurred losses (not including safety margin) was an increase of \$46,112, less than 1% of the total ultimate incurred (\$77,553,080 ultimate incurred estimated by the actuary).

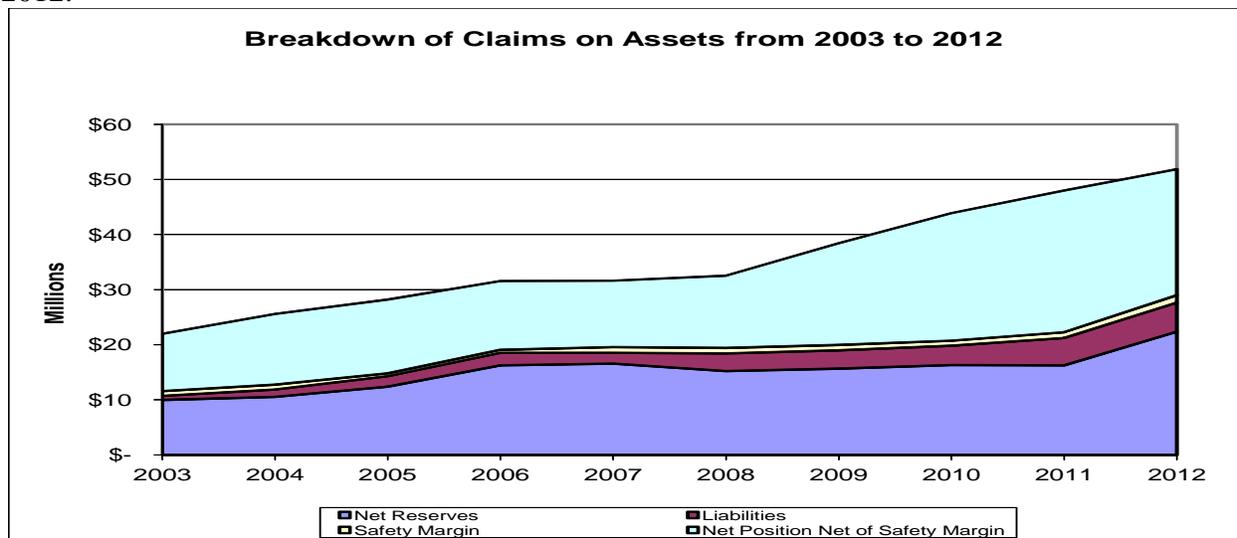
VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Highlights (Continued)

- Net case and non case (IBNR) reserves as of December 31, 2012, increased by 39% or \$5,820,201 from December 31, 2011, from \$15,100,837 to \$20,921,038, driven primarily by adverse development of prior year workers' compensation claims. By comparison, net case and non case (IBNR) reserves as of December 31, 2011 decreased by 2% from 2010, from \$15,383,674 to \$15,100,837. The claims expense reserve and the workers' compensation state assessment reserve increased 25% over last year, from \$1,172,315 in 2011 to \$1,462,818 in 2012. The increase in the prior year was also 25%. The increase in 2011 from 2010 was primarily due to an increase in the number of property and liability claims. Property claims frequency increased 105% due to tropical storm Irene and the number of liability claims experienced a 29% increase in the auto and general liability lines of coverage. From 2011 to 2012, the increase was due to the combination of a 17% per claim cost increase and a 38% frequency increase in lost time claims under workers compensation coverage.

The graph below measures the trend of the breakdown for each type of obligation (liabilities, reserves, safety margin and unrestricted net position) against the Fund's total assets and clearly shows the growth of net position over time in relation to the liabilities, net reserves and safety margin. Loss development remained fairly stable between 2006 and 2011, allowing the Fund to strengthen its net position. This solid net position combined with reinsurance coverage that eliminated most of the risk for catastrophic events, such as Tropical Storm Irene, protected the Fund and allowed it to continue to grow surplus in 2011. Adverse claim development in 2012 increased net reserves and decreased net position, but as is shown in the graph, an increase in total assets (primarily due to strong investment performance) and a strong unrestricted net position allowed the Fund to sustain the downturn with little impact on its fiscal stability. The safety margin has been discounted for future investment earnings at a rate of 3.5% for 2008-2012.



VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Highlights (Continued)

Overview of the Fund's Financial Statements

The Fund's fiscal year is January 1 through December 31 and there are a total of twenty-four active funds, twenty-three of them constituting fund years to account for claims in their respective policy years. The remaining one, the surplus reserve fund enables the Fund to take on more risk with higher self insured retentions and long term investment strategies, as well as absorb any unusual growth in membership or unexpected adverse claim development.

The Fund operations are divided into seven cost centers in order to better internally manage the budgets for administrative costs. These cost centers are:

- Reinsurance
- Administration
- Underwriting
- Member Relations
- Loss Control (Safety and Health Promotion)
- Wellness
- Claims

The first cost center is shown as reinsurance expenses in the financial statements presented in this report. The next six cost centers, administration through claims, are combined and included under the operating or administrative costs in the financial statements.

The annual financial report consists of four parts:

- Management's Discussion and Analysis
- Financial Statements and Disclosures
- Required Supplementary Information
- Other Information

Management's discussion and analysis provides a narrative overview of the statements and comments on significant developments during the reporting period. The intention is to present a financial summary of operations for the past fiscal year and discuss the outlook for the ensuing year.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Overview of the Fund's Financial Statements (Continued)

Required Financial Statements include:

- Statements of Net Position
- Statements of Contributions, Expenses and Changes in Net Position
- Statements of Cash Flows
- Notes to the Financial Statements

These statements present the Fund's status at December 31, 2012 and 2011 and financial developments during 2012 for all cost centers combined.

The statement of net position presents the economic position of the Fund, showing the assets owned by the Fund and how those assets are financed: by debt or short-term obligations, actuarially determined reserves, and by net position (the Fund's equity), previously known as the "fund balance" or "net assets" and more commonly known in the insurance industry as "surplus".

The statement of contributions, expenses and changes in net position shows the operating transactions for the year, revenue and expenses. This statement is classified by operating and non-operating revenues and expenses. As required by GASB, investment income is considered a non-operating revenue and member distributions a non operating expense. Despite this categorization, investment income and member distributions are integral to insurance company operations. The net result of operations is known as the change in net position (essentially the Fund's "equity"). This figure added to last fiscal year's net position is the new net position total shown in both the statement of net position as well as the statement of contributions, expenses and changes in net position. Net position is made up of both restricted and unrestricted equity. Restricted net position is that portion that is limited for a particular use by action of the governing board. All remaining equity is considered unrestricted net position.

The statement of cash flows outlines the cash flow resulting from operations, investment, and financing activities of the Fund.

Notes to the financial statements provide explanations of the accounting principles followed and of key items in the statements. They include tables showing detailed analysis of certain accounts.

The required supplementary schedules include the ten year claims development schedule and the reconciliation of claim liabilities by type of contract. The supplementary schedules include the combining statement of net position, combining statement of contributions, expenses and changes in net position and the schedule of general and administrative expenses. The other information is presented for purposes of additional analysis and are not a required part of the basic financial statements.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Overview of the Fund's Financial Statements (Continued)

Please note that in the following analysis, when ratios are discussed, insurance terms are used along with the standard accounting terms. In the insurance industry “surplus” is used for the accounting term “net position”, “net assets” or “fund balance”, and “premium” is used for “contributions”. Accounting and insurance terms may be used interchangeably in the following sections when discussing ratios.

Results and Analysis

The following table summarizes the statement of net position for 2012 with a comparison to 2011 and 2010, and shows the percentage change. Unrestricted net position includes the safety margin, that portion that is designated to ensure that the Fund has enough reserve to meet the 90% confidence level for protection from adverse claim development or catastrophic events that could negatively impact financial results.

Financial Analysis					
	December 31, 2012	December 31, 2011	Percentage Change	December 31, 2010	Percentage Change
Cash and Investments	\$ 49,221,039	\$ 45,379,698	8.5 %	\$ 41,115,146	10.4 %
Other assets	<u>2,664,920</u>	<u>2,632,245</u>	1.2 %	<u>2,784,694</u>	(5.5)%
Total assets	51,885,959	48,011,943	8.1 %	43,899,840	9.4 %
Current liabilities	5,284,016	4,966,913	6.4 %	3,515,248	41.3 %
Noncurrent liabilities	<u>22,383,856</u>	<u>16,273,152</u>	37.6 %	<u>16,320,704</u>	(0.3)%
Total liabilities	27,667,872	21,240,065	30.3 %	19,835,952	7.1 %
Net position					
Restricted	1,200,000	1,500,000	(20.0)%	1,000,000	50.0 %
Unrestricted	<u>23,018,087</u>	<u>25,271,878</u>	(8.9)%	<u>23,063,888</u>	9.6 %
Total net position	<u>\$ 24,218,087</u>	<u>\$ 26,771,878</u>	(9.5)%	<u>\$ 24,063,888</u>	11.3 %

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

As of December 31, 2012, total assets increased by 8.1% from \$48,011,943 to \$51,885,959, compared to an increase of 9.4% from 2010 to 2011. Positive investment performance accounts for the increase in total assets during 2012. About a third of the increase from 2010 to 2011 was due to investment performance with the remaining balance from an increase in cash collected in advance from members for contributions and from reinsurers for Irene claims that were in excess of retention.

As of December 31, 2012, total current liabilities increased by 6.4% from \$4,966,913 to \$5,284,016. Total current liabilities in 2011 increased 41.3% over 2010. The increase in 2012 is primarily due to an 11% increase in member contributions paid in advance, reflecting the 2013 renewal rate increase. These receipts for contributions paid in advance will not be recognized as revenue until 2013 and are therefore a liability to the Fund. The Fund experienced a much larger increase during 2011 for member contributions paid in advance and reinsurance received in advance for claims resulting from damage caused by Tropical Storm Irene (represented approximately one third of the total increase).

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

Net reserves increased by 39% from 2011 to 2012, compared to a 2% decrease from 2010 to 2011. The 2012 increase reflects adverse development primarily in prior year workers' compensation claims. Total case and non-case (IBNR) reserves are broken out by fund year in the following table:

<u>Fund Year</u>	<u>12/31/2012</u>	<u>12/31/2011</u>	<u>12/31/2010</u>
1993	\$ 6,174	\$ -	\$ -
1994	-	35,073	30,796
1995	-	13,337	21,173
1998	-	-	10,635
1999	48,729	57,951	54,746
2000	-	-	-
2001	180,624	298,158	152,742
2002	243,445	234,637	232,984
2003	222,098	222,579	263,331
2004	157,857	160,223	283,942
2005	301,279	318,209	752,668
2006	557,659	572,584	1,331,680
2007	740,186	834,963	1,533,712
2008	2,155,636	1,824,429	2,153,158
2009	2,131,959	2,176,981	3,697,373
2010	3,330,509	3,411,248	4,864,734
2011	3,751,544	4,940,465	-
2012	<u>7,093,339</u>	<u>-</u>	<u>-</u>
Totals	<u>\$ 20,921,038</u>	<u>\$ 15,100,837</u>	<u>\$ 15,383,674</u>

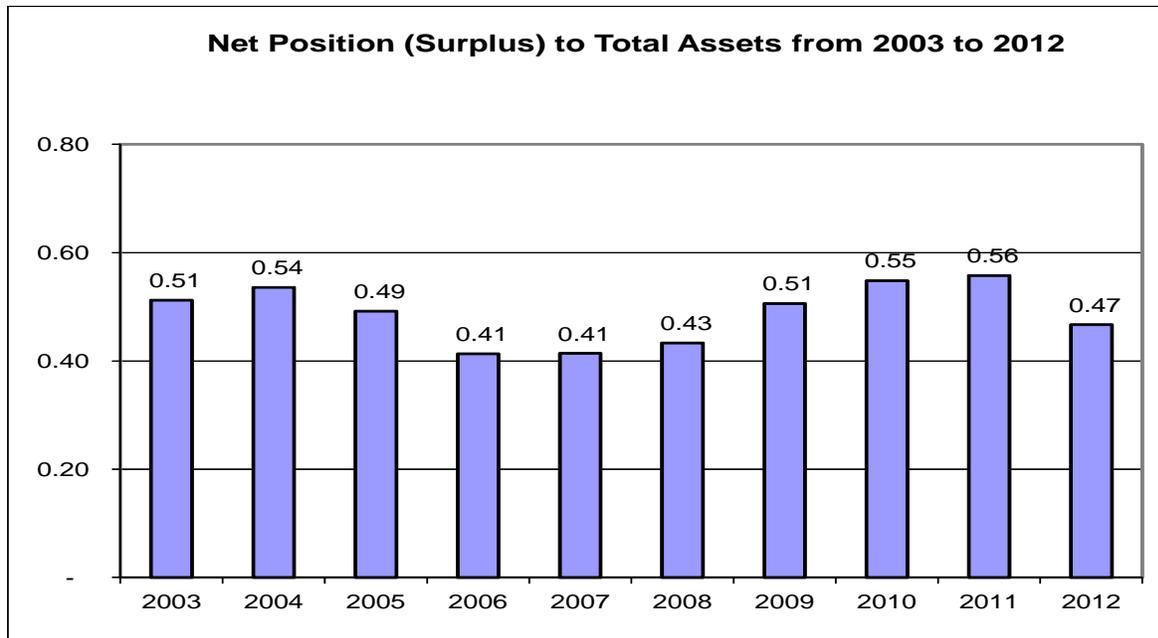
As outlined in the Highlights section, total net position at year end was \$24,218,087 down from \$26,771,878 at the same time last year. The 2011 to 2012 decrease of \$2,553,791 is primarily due to the adverse claim development in prior years workers' compensation claims during 2012.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

The net position to total assets ratio measures the Fund's surplus against the value of its total assets. A higher ratio is positive, providing more of a cushion against unexpected losses, poor investment returns, or operating deficits. The 2012 ratio of 0.47 means that almost half of all the Fund's assets are available to cover any of these potential problems. Net position or surplus as a ratio to total assets has fluctuated over time from 0.41 in 2006 and 2007 to a high of 0.56 in 2011. Improved investment earnings played a large part in the increase from 0.43 in 2008 to 0.51 in 2009. In 2010 and 2011 the upward trend continued from both positive earnings and operating surpluses. The 2012 operating loss proved that strong net position could allow the Fund to weather rather significant adverse claim development without materially impacting its fiscal strength. Related ratios examining pool solvency are presented later in this report along with the analysis of the statement of contributions, expenses and changes in net position.



VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

The following table summarizes the Statement of Contributions, Expenses and Changes in Net Position as of 2012 with a comparison to 2011 and 2010, showing the percentage changes:

Summary of Contributions, Expenses, and Changes in Equity	2012	2011	Percentage Change	2010	Percentage Change
Fund contributions	\$ 18,526,721	\$ 17,550,963	5.6 %	\$ 18,077,511	(2.91)%
Other revenues	<u>15,750</u>	<u>46,163</u>	(65.9)%	<u>41,866</u>	10.26 %
Total operating revenues	<u>18,542,471</u>	<u>17,597,126</u>	5.4	<u>18,119,377</u>	(2.9)%
Operating expenses:					
Provision for losses and loss adjustment expenses	15,098,797	9,669,523	56.1 %	9,157,602	5.6 %
Broker fees	123,787	146,348	(15.4)%	146,889	(0.4)%
Reinsurance premiums	3,893,071	3,065,166	27.0 %	2,837,441	8.0 %
Other operating expenses	<u>3,989,863</u>	<u>3,577,819</u>	11.5 %	<u>3,435,890</u>	4.1 %
Total operating expenses	<u>23,105,518</u>	<u>16,458,856</u>	40.4 %	<u>15,577,822</u>	5.7 %
Operating (loss) income	<u>(4,563,047)</u>	<u>1,138,270</u>	(500.9)%	<u>2,541,555</u>	(55.2)%
Non-operating revenues:					
Investment income	1,511,885	1,496,958	1.0 %	1,413,383	5.9 %
Net (decrease) increase in fair value of investments	1,871,487	982,949	90.4 %	1,521,391	(35.4)%
Investment fees	<u>(124,109)</u>	<u>(118,187)</u>	5.0 %	<u>(110,742)</u>	6.7 %
Total non-operating revenues	3,259,263	2,361,720	38.0 %	2,824,032	(16.4)%
Member distribution- contribution credit	<u>1,250,007</u>	<u>792,000</u>	57.8 %	<u>750,000</u>	5.6 %
Non-operating income	<u>2,009,256</u>	<u>1,569,720</u>	28.0 %	<u>2,074,032</u>	(24.3)%
Change in net position	(2,553,791)	2,707,990	(194.3)%	4,615,587	(41.3)%
Net position at beginning of year	<u>26,771,878</u>	<u>24,063,888</u>	11.3 %	<u>19,448,301</u>	23.7 %
Net position at end of year	<u>\$ 24,218,087</u>	<u>\$ 26,771,878</u>	(9.5)%	<u>\$ 24,063,888</u>	11.3 %

The 2012 year ended with an operating loss (operating revenue under operating expenses before net investment income and distributions) of \$4,563,047. This loss was reduced by net investment earnings of \$3,259,263 for a net loss of \$1,303,784 before distribution of member contribution credits including member contribution credits of \$1,250,007, total net position for the year decreased by \$2,553,791.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

In contrast, 2011 generated operating income of \$1,138,270, which was increased by net investment earnings of \$2,361,720. Combined net earnings were \$3,499,990 before a member contribution credits of \$792,000 and net position increased by \$2,707,990.

The total incurred losses at December 31, 2012 totaled \$15,098,797. Incurred losses are comprised of two components: (1) the provision for losses which relate to insured events of the current year; and (2) a charge (or credit) for adjustments to incurred losses for all prior policy years. The adjustment for all prior policy years is referred to as favorable or unfavorable (adverse) development. The fund incurred losses of \$10,072,389 on the 2012 policy year, and recorded unfavorable development of \$5,026,408 on prior policy years from 1993 to 2011. The unfavorable development of prior years occurred in a combination of lines of coverage with 57% of the increase in workers' compensation, 16% in general liability, and 11% in auto liability with the balance equally distributed to the public officials and property coverage. In comparison, losses incurred during 2011 totaled \$9,623,411 on the 2011 policy year and recorded unfavorable development of \$46,112 on prior year development. During 2010, the Fund incurred losses of \$8,363,446 on the 2010 policy year and unfavorable development of \$794,156 for prior years.

Investment returns net of fees (including unrealized gains and losses) increased by 38% in 2012 over 2011, compared to a decrease of 16% from 2010 to 2011. Interest and dividend income increased 1% in 2012 compared to an increase of 6% in 2011. Market volatility was the primary driver for both the large increase in 2012 investment performance, as well as the decrease in 2011, yielding 90% more market gain in 2012 than in 2011, and 35% less in 2011 than in 2010.

Excluding the investment in NLC Mutual Insurance Company, the Fund had 85% of their investments in fixed maturity securities and cash equivalents, and 15% invested in equity securities. Including the NLC investment, equities comprise 19% of the portfolio and 35% of net position or surplus. The Fund's investment policy target asset allocation is 75% fixed maturity and 25% equities, however, the policy states that "up to 25% of admitted Fund assets, but no more than 50% of Fund Surplus shall be invested in high yield bonds, preferred and common stocks or mutual funds investing in these instruments." The balance must be invested in fixed income securities. Positive market performance in the fixed income portfolio resulted in an allocation of equities below 25% of the total portfolio for 2012 and below 50% of surplus.

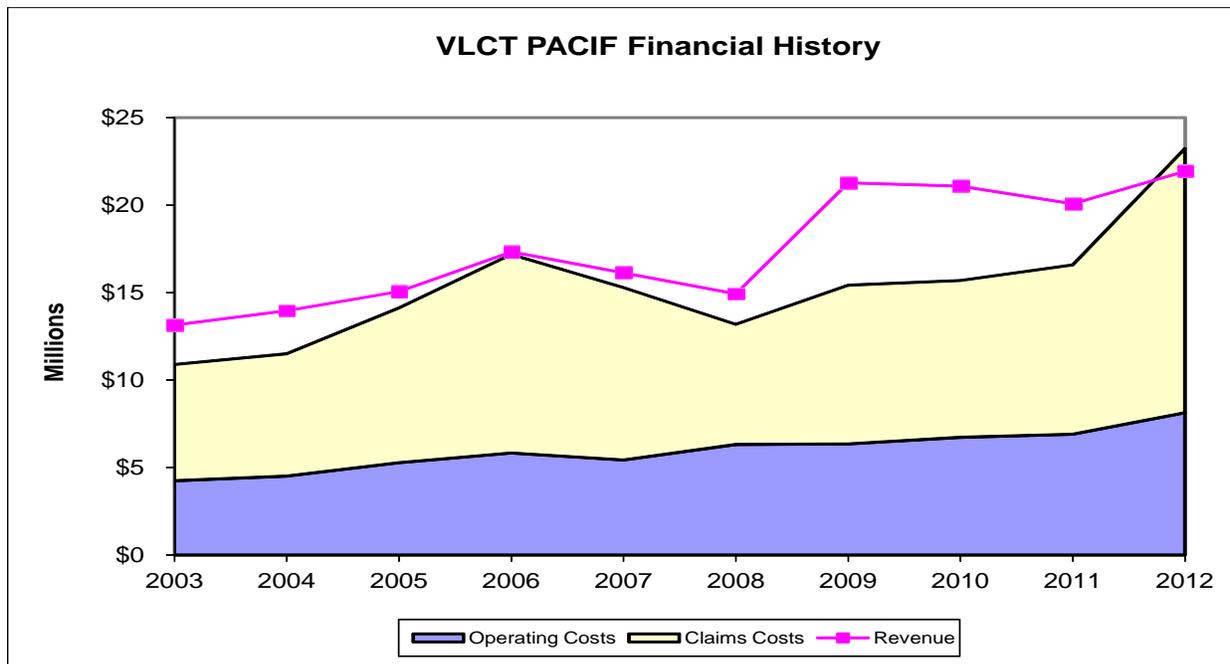
The Fund's fixed maturity investments had a weighted return net of fees of 7.0% (down from 7.9% last year), 2.2% above the Fund's benchmark of 4.8%, which represents the Barclays Capital Aggregate benchmark. Equity investments had a weighted return of 15.2% (up from 0.9% last year), 1.5% below the Fund's benchmark of 16.7%, which represents the Russell 3000 benchmark.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

The graph below shows in summary form the trend of the Fund's revenues and expenses. This graph reflects the variability of claims over time. Please note that Burlington left the Fund at the end of 2006. At that point losses began a sharp decrease before climbing back up in 2009. The expenses do not include distributions, which are taken from prior year surpluses (net position). The gap between the revenue trend line and the combined claims and operating costs line represents the surplus or deficit (if the line drops below the area representing costs) each year. A portion of these annual surpluses become distributions to members as determined by the actuary and approved by the Board. This clearly shows that the Fund has been successful in its underwriting, covering costs adequately over time, maintaining a solid surplus or net position and returning that surplus back to its members. The adverse (unfavorable) development that occurred in 2012 is clearly shown in this graph, represented by the sharp increase in claims costs. The volatility of claims over time (an average of 12% over the period 2003-2012) is apparent when compared to the trend of operating costs that show a gradual increase over the same period (an average of 8% including reinsurance cost increases).

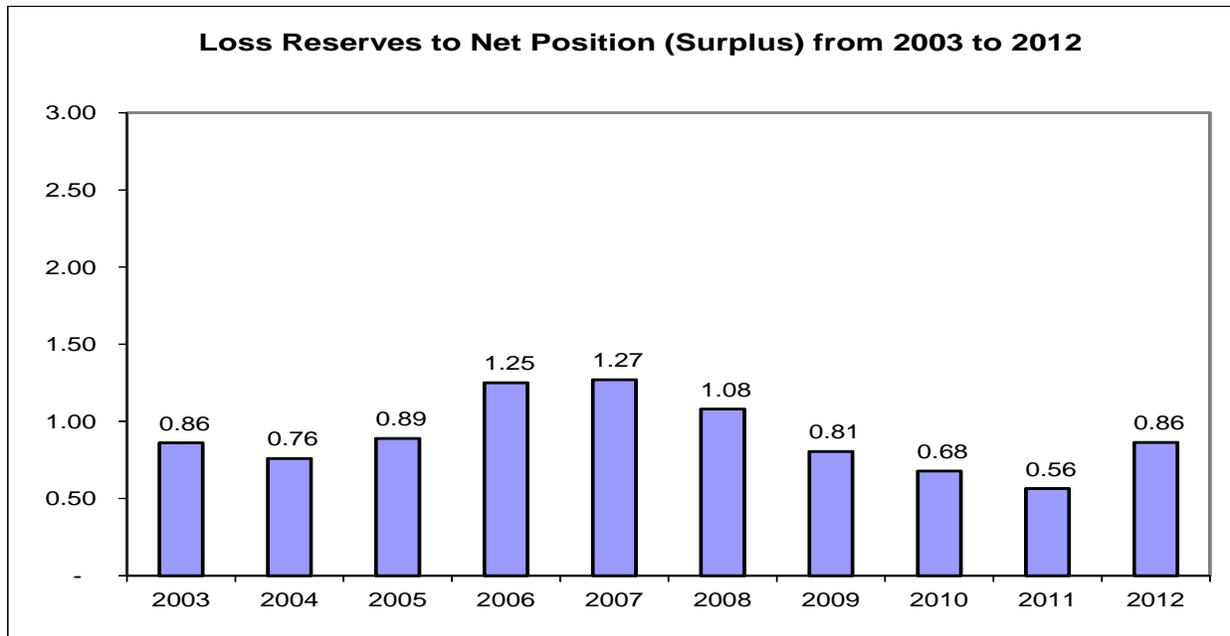


VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

One way to measure the adequacy of the Fund's net position or surplus is to analyze the accuracy of its loss development projections. Loss reserves are actuarially determined to pay claims as they develop over time. Measuring reserves against net position (surplus) gives an indication of the Fund's solvency by looking at whether or not it is able to cover higher than expected losses due to claim development that exceeds the forecast. The higher the reserve to net position ratio the more important it is to accurately estimate IBNR (incurred but not reported) claims to be certain that reserves are adequate to cover those future claim costs. A high ratio may indicate that surplus is too low and there is a significant risk of insolvency if losses are greater than anticipated. A ratio of less than 3.00 (3:1) is considered a comfortable margin for deviations in expected reserve estimates. The Fund's loss reserve to surplus ratio over the past ten years is shown below.



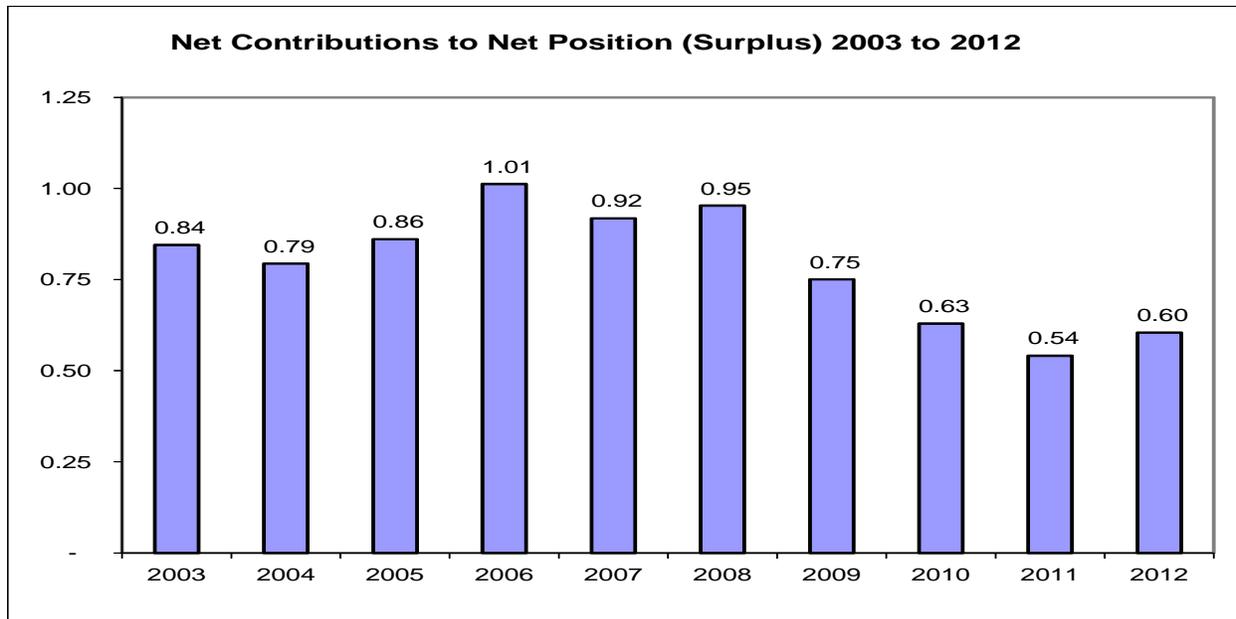
This ratio continues to be well below 3.00 and shows that the Fund's net position has the capacity to sustain fairly material impacts from adverse (unfavorable) development without catastrophic consequences to its financial strength. Years showing a ratio exceeding 1.0 were years with adverse claim development combined with lower surplus. The 2012 ratio, despite significant claims costs, was less than 1.0 mainly due to the more substantial surplus developed from positive operating and investment results between 2009 and 2011.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

In addition to analyzing sufficiency of funds to cover for unexpected deficits and deviations from loss estimation, it is also necessary to determine if net position (surplus) will be adequate if the Fund's pricing doesn't cover potential losses. Net contributions (contributions less reinsurance) to net position ratios, as shown on the following chart, will measure this type of exposure. A ratio over 3.00 means that there is significantly less net position or surplus to cover unexpected losses, thereby increasing risk exposure. A ratio at or below 1.00 is considered a comfortable margin in public risk pools as a general rule. The Fund has gradually decreased this ratio from a high of 1.01 in 2006 with the ratio benefiting from the loss of Burlington and generally favorable underwriting results, aside from 2012. Commercial standards use a 2:1 ratio as a benchmark, considering a 1:1 ratio to be a very strong position. The current ratio meets the pool standard and, with a solid surplus, allows more flexibility in underwriting in future years.



VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

The ten year trends in these three key ratios are indicators of a generally positive position when performance is analyzed on the basis of the ability to cover unanticipated losses or year end deficits. Potential problems that create fiscal stress include higher than projected losses in a given year or investment income that does not meet expectations, which the Fund experienced in 2002, 2005, 2006 and 2008. From 2009 to 2011, claims steadily increased but with no significant spikes, allowing the Fund to build surplus from strong investment earnings and operating surplus. Tropical Storm Irene related property claims in 2011 might have had a significant impact on these ratios if property reinsurance had not covered all but the Fund's \$500,000 retention. However net position at the beginning of 2011 was \$10 million higher than in or before 2008, so the impact of Irene without the reinsurance would have been much less devastating to the Fund than it would have been had it happened in 2008. The adverse (unfavorable) claim development that occurred in 2012 further strengthens the argument for maintaining a strong net position or surplus. Losses in 2006 and again in 2012 were essentially absorbed by a surplus that was substantial enough to cover unexpected adverse development. Similarly, the Fund was able to absorb poor investment results in 2008. The Fund has continued to maintain its strong net position and remains well positioned to absorb future unexpected losses, catastrophic events or poor investment earnings.

It should also be noted that there are two other factors to consider when analyzing the Fund's susceptibility to risk. First, liability and workers' compensation coverage are generally subject to more risk or unpredictability than property coverage. As these coverages increase as a percentage of overall exposures, so too does the risk. As a general rule, when you have more liability and workers' compensation exposures in your book of business, it becomes more important to show a lower ratio of contributions to net position. Liability and workers' compensation have a longer tail and as a result, losses can be much less predictable over time. However, because the mix of liability and property coverage for pool members is stable over time, i.e., changes occur in membership rather than in lines of coverage, there would be little variability in the amount of risk over time that was attributable to a coverage shift. Although the Fund's workers' compensation premiums constitute 35% of the total book of business, the longer tail for these claims makes forecasting future costs less certain and necessitates a more substantial cushion against unexpected losses.

Second, the higher the proportion of more risky investments in the investment portfolio, the greater is the impact of a bad investment year on any available net position. If you factor in the NLC Mutual investment, the Fund currently has 19% of its investments in higher risk investments with 81% in less risky fixed-maturity securities and cash equivalents. However, with close to 35% of the claims exposure in longer tail liability and workers compensation, the Fund has more time to recoup market losses and can thus tolerate more investment risk. In accordance with the Fund's investment policy, the target for equity investments is 25% but no more than 50% of Fund surplus. The current ratio of equity investments to surplus is 35%.

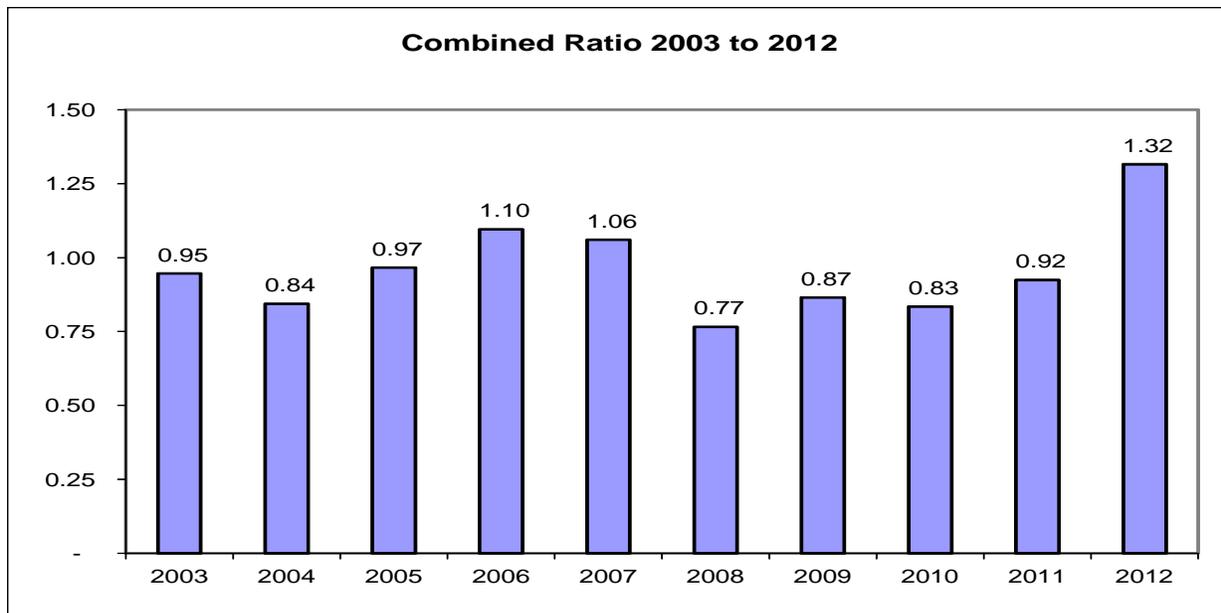
VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Results and Analysis (Continued)

Maintaining investments within these guidelines helps the Fund manage that risk.

Another useful measure of the Fund's financial condition is the combined ratio, the total of the loss and expense ratios. It is a common insurance industry ratio with a benchmark of 1.00. The difference between the combined ratio and 1.00 is an "underwriting gain" or an "underwriting loss". Underwriting losses can be offset by investment gains. Higher loss or expense ratios make it more important to maximize investment income in order to end the year with a surplus. That surplus, of course, may ultimately result in member distributions, depending on how losses develop over the course of time. In 2012, the Fund has experienced its highest combined ratio since 2006, with some significant adverse (unfavorable) claim development. In 2006, the spike occurred after two years of adverse claim development and was followed by a reversal of this trend through 2011. A reduction in contributions combined with increases in losses and reinsurance moved this ratio from .83 in 2010 to .92 in 2011. Adverse claim development in 2012 increased it to 1.32. The Board approved a rate increase for 2013 which will help move this ratio closer to the benchmark.



VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Outlook/Economic Factors

Fund year 2013 renewal contribution levels increased by 8% to reflect adverse prior year loss development, an increase in the average cost per claim, and higher projected losses going forward. In spite of the rate increase, all members renewed their membership in PACIF for 2013. This increase follows two years of flat rates.

The Board directed \$1,200,000 from Net Position to be returned to the membership based on an actuarial analysis of the financial status of prior fund years. This is a 17% decrease from last year's distribution. Of this total, \$1,000,000 will be returned to members as contribution credits and \$200,000 was allocated to fund the safety equipment grant program. Each member's specific credit is derived via a formula that contemplates the fund years generating the surplus, the overall Fund loss ratio for those years, the number of surplus generating years that the member was in the Fund, and the member's loss ratio in those years. The distribution credit is shown as credit against the member's 2013 contribution, and the member must renew in the Fund in order to receive the credit. Since inception, the Fund has returned over \$16 million in contribution credits to the membership.

The 2013 Coverage Document was updated with the many of the changes being technical in nature. The Board discontinued the purchase of a separate accident and disability policy for volunteer firefighters of the Fund's member departments because changes to the workers compensation statute eliminated the need for this coverage. The Crime section of the Coverage Document was extensively rewritten to tighten up the coverage language as well as to bring it up to date. Property coverage for covered bridges was rewritten to incorporate lessons learned from Tropical Storm Irene covered bridge claims.

The Fund is continuing to assist members in their risk management initiatives with a focus on workers' compensation. This is an area where the Fund believes it can have a big impact on reducing claims and to drive down members' contribution charges by helping them to help themselves. This is most effective when every employee, administrative staff person and the governing body of every member acknowledges that they all share in the responsibility to develop and maintain a culture of safety in the workplace and community. The advice from claims (AFC) and incident review process (IRP) initiatives are having a great impact on emerging claim trends and the Fund's more severe workers' compensation claims.

In addition to an emphasis on workers' compensation safety, the Fund continues to provide a wide range of training and educational services to the membership to bring awareness to and assistance in implementing risk management best practices in areas such as driving skills, flagger certification, law enforcement training, employment practices and internal financial controls.

In 2010, the Fund launched the PACIF Safety Equipment Grant Program, which provides a 50/50 funding match up to \$5,000 for the purchase of specific safety related equipment. This program continues to be enormously successful. In 2013 the rules for this program have been changed. In order to be eligible for a grant, a member cannot have any outstanding level "A"

VLCT Property and Casualty Intermunicipal Fund, Inc.

Management's Discussion and Analysis (Continued)

Outlook/Economic Factors (Continued)

recommendations from our loss control staff. Level "A" recommendations are those where the situation will be the "direct cause" of a covered loss and the noted hazard is an imminent danger situation.

In 2013, the Fund will bring another new program to life. Through a contract with Agility Recovery members will have access to services that help them to prepare for a potential disaster before it strikes and have available access to temporary onsite resources for recovering quickly from a damaging event.

The success of the Fund's programs is a testament of the power of pooling Vermont municipalities together for their mutual benefit. It is the Fund's mission to relentlessly pursue the goal of providing member municipalities with broad coverage and superior risk management services and consultation for a fair and competitive price. PACIF may not be the low bid in any given year, but it is always the better value and will prove to be the overall lower cost in the long run.

Requests for Information:

For additional information, please contact the Finance Department of the Vermont League of Cities and Towns, 89 Main Street, Suite 4, Montpelier, Vermont, 05602-2948, or call 802-229-9111.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Statements of Net Position

	As of December 31,	
	2012	2011
Assets		
Investments		
Fixed-maturity securities, at fair value	\$ 34,415,899	\$ 31,464,715
Mutual funds, at fair value	5,848,076	5,011,256
Investment in NLC Mutual Insurance Company	2,109,603	2,026,321
Total investments	42,373,578	38,502,292
Cash and cash equivalents	6,847,461	6,877,406
Accrued investment income	296,281	330,167
Contributions receivable	313,222	423,785
Accounts receivable - deductibles and subrogation	-	167,735
Prepaid expenses	898,095	785,229
Reinsurance recoverable - paid losses	650,630	303,394
Other assets	506,692	621,935
Total Assets	\$ 51,885,959	\$ 48,011,943
Liabilities and Net Position		
Liabilities		
Losses and loss adjustment expenses, net of reinsurance	\$ 20,921,038	\$ 15,100,837
Accounts payable	291,946	365,904
Net subrogation and reinsurance payable	365,024	-
Contributions collected in advance	4,627,046	4,154,599
Reinsurance collected in advance	-	446,410
Claims expense and workers' compensation state assessment reserve	1,462,818	1,172,315
Total liabilities	27,667,872	21,240,065
Net Position		
Restricted		
Contribution credits	1,000,000	1,250,000
Safety grant program	200,000	250,000
Unrestricted	23,018,087	25,271,878
Total net position	24,218,087	26,771,878
Total Liabilities and Net Position	\$ 51,885,959	\$ 48,011,943

See accompanying notes to the financial statements.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Statements of Contributions, Expenses, and Changes in Net Position

	Years ended December 31,	
	2012	2011
Operating Revenues		
Fund contributions	\$ 18,526,721	\$ 17,550,963
Other income	15,750	46,163
Total operating revenues	18,542,471	17,597,126
 Operating Expenses		
Losses and loss adjustment expenses, net of reinsurance	15,098,797	9,669,523
General and administrative expenses	3,989,863	3,577,819
Reinsurance expenses	3,893,071	3,065,166
Broker fees for reinsurance	123,787	146,348
Total operating expenses	23,105,518	16,458,856
Operating (loss) income	(4,563,047)	1,138,270
 Non-Operating Revenues (Expenses)		
Investment income - interest and dividends	1,428,603	1,409,700
Investment income - net change in fair value	1,871,487	982,949
Investment income - NLC Mutual Insurance Company	83,282	87,258
Investment management fees	(124,109)	(118,187)
Net non-operating revenue	3,259,263	2,361,720
Member distributions - contribution credit	1,250,007	792,000
Non-operating income, net	2,009,256	1,569,720
Change in Net Position	(2,553,791)	2,707,990
Net Position, Beginning of Year	26,771,878	24,063,888
Net Position, End of Year	\$ 24,218,087	\$ 26,771,878

See accompanying notes to the financial statements.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Statements of Cash Flows

	Years ended December 31,	
	2012	2011
Cash Flows from Operating Activities		
Receipts from members	\$ 17,859,724	\$ 17,611,167
Receipts for miscellaneous income	15,750	46,163
Payments for reinsurance expenses	(4,005,937)	(3,361,619)
Net payments for claims and claims adjustment expenses	(9,248,980)	(8,937,420)
Payments for administrative and general expenses	<u>(4,072,365)</u>	<u>(3,449,045)</u>
Net cash provided by operating activities	548,192	1,909,246
Cash Flows from Investing Activities		
Cost of investments purchased	(27,790,188)	(22,193,714)
Proceeds from sales and maturities of investments	25,790,389	21,648,952
Net receipts for interest and dividends	<u>1,421,662</u>	<u>1,372,357</u>
Net cash provided by (used in) investing activities	<u>(578,137)</u>	<u>827,595</u>
Net change in cash and cash equivalents	(29,945)	2,736,841
Cash and Cash Equivalents, Beginning of Year	<u>6,877,406</u>	<u>4,140,565</u>
Cash and Cash Equivalents, End of Year	<u>\$ 6,847,461</u>	<u>\$ 6,877,406</u>
Reconciliation of Net Income to Net Cash Provided By Operating Activities		
Operating (Loss) Income	\$ (4,563,047)	\$ 1,138,270
Add (deduct) items not affecting cash:		
Member distributions - contribution credit	(1,250,007)	(792,000)
Changes in assets and liabilities:		
Contributions receivable	110,563	60,832
Accounts receivable - deductibles and subrogation	532,759	420,703
Prepaid expenses	(112,866)	(296,453)
Reinsurance recoverable - paid losses	(347,236)	(87,458)
Other assets	115,243	61,239
Losses and loss adjustment expenses, net of reinsurance	5,820,201	(282,837)
Accounts payable	(73,958)	213,883
Contributions collected in advance	472,447	791,372
Reinsurance collected in advance	(446,410)	446,410
Claims expense and workers' compensation state assessment reserve	<u>290,503</u>	<u>235,285</u>
Net Cash Provided by Operating Activities	<u>\$ 548,192</u>	<u>\$ 1,909,246</u>

See accompanying notes to the financial statements.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements

Years ended December 31, 2012 and 2011

Note A - Organization and Nature of Operations

VLCT Property and Casualty Intermunicipal Fund, Inc. ("the Fund") was established in June 1986, to (1) provide, directly and indirectly, members of the Vermont League of Cities and Towns ("VLCT") with various forms of property, workers' compensation, casualty and fidelity insurance, reinsurance, and excess insurance through admitted and surplus lines carriers, (2) develop self-insurance and risk retention pools for the benefit of members of VLCT, (3) act as an advocate before governmental regulatory agencies with respect to municipal property and casualty insurance coverage and availability, and (4) develop, promote and implement risk management, risk containment and loss control programs for the benefit of Vermont municipalities and their employees.

Political subdivisions joining the Fund must remain members for a minimum of one year and may withdraw from the Fund after that time by giving notice sixty (60) days prior to the end of the fund year. Fund underwriting and rate setting policies have been established after consultation with an actuary. Fund members are subject to a supplemental assessment in the event of deficiencies. If the assets of the Fund were to be exhausted, members would be responsible for the Fund's liabilities. At December 31, 2012 and 2011, the Fund provided property and casualty and workers' compensation coverage to 325 and 324 political subdivisions including cities, towns, villages and special purpose districts providing water, solid waste management and fire protection, respectively.

The Fund receives its contributions from municipalities based upon the loss experience of the Fund, operating expenses, excess insurance and reinsurance costs, and exposures for each member. Such contributions are used to pay all administrative expenses, reinsurance costs, claims and claims-related costs. The Fund maintains separate funds for each plan year to reserve monies for claims related to those years.

Fund members may be subject to an additional assessment for an amount determined by the Fund's Board of Directors ("the Board") to fund the loss fund. In the event that an assessment is required, such assessment shall be made against individual members in the proportionate share of each member's contribution to the total contribution for that fund year. The Board shall adjust the assessment of members prior to the commencement of each subsequent fund year, upon the advice of an actuary as to the extent of loss fund deficiency. No such assessment has been determined since the Fund's inception in 1986.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies

Basis of Accounting

The financial statements of the Fund have been prepared using the accrual basis of accounting in conformity with accounting principles generally accepted in the United States ("GAAP") as applied to governmental entities. In accordance with Government Accounting Standards Board ("GASB") Statement No. 62 *Codification of Accounting and Financial guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* ("Statement No. 62"), the Fund follows all applicable GASB guidance. The Fund uses the economic resources measurement focus and the accrual basis of accounting and is accounted for as a proprietary enterprise fund.

Subsequent Events

The Fund has evaluated subsequent events for disclosure and recognition through March 13, 2013, the date on which these financial statements were available to be issued.

Fund Detail

The Fund's fiscal year is January 1 through December 31 and there are a total of twenty-five active funds, twenty-four of them constituting fund years to account for claims in their respective policy years. The remaining fund, the Surplus Reserve Fund, was established to cover unanticipated deficits in the individual fund years, as well as enables the Fund to take on more risk with higher self-insured retentions and long-term investment strategies, and absorb any unusual growth in membership or unexpected adverse claim development.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein. Significant estimates included in these financial statements primarily relate to the assumptions and methods used to estimate the ultimate liability for unpaid losses as described below.

Both the Fund's operating results and financial condition are affected by numerous factors and circumstances inherent within the insurance industry, some of which it can neither predict nor control. Among them are (1) the Fund's ability to enter into suitable future reinsurance agreements is subject to prevailing conditions in the reinsurance markets which may change risk-retention levels; (2) fluctuations in interest rates impact the value and income yield of the Fund's investment portfolio in the short-term, and often affect default and prepayment rates over time; (3) future inflation may result in ultimate loss settlements different from the amounts originally anticipated; (4) future catastrophic or unusual losses, such as the effects of the terrorist attacks of September 11, 2001, may distort historical experience; and (5) losses may not fully emerge for several years following the year in which the insured event occurred. Should any of these or similar events occur, the Fund's operating results and financial condition may be affected.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

Investments

The Fund accounts for its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* ("Statement No. 31"). Statement No. 31 establishes fair value standards on accounting for all investments held by governmental external investment pools and governmental entities. All investment income, including changes in the fair value of investments, is recognized in the statements of contributions, expenses and changes in net position. Realized gains and losses on the sale of investments are recognized on the specific identification basis to determine the costs of the investments sold. The calculation of realized gains and losses is independent of the calculation of the net change in fair value of investments. Realized gains and losses on investments that had been held for more than one year and sold in the current year were included as a change in the fair value of investments reported in the prior years and the current year. Investment purchases are recognized on the trade date. Investments are stated at fair value based on quoted market prices or through a recognized pricing service.

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures - an amendment of GASB Statement No. 3*, certain disclosures regarding deposit and investment risks have been provided in Note D.

Investment in NLC Mutual Insurance Company

The Fund is a member of the NLC Mutual Insurance Company ("NLC"), which qualifies as a joint venture in accordance with GASB Statement No. 14, *The Financial Reporting Entity*. Accordingly, the Fund initially recorded its interest at cost and subsequently records its equity interest calculated in accordance with the relevant participation agreements based on unaudited financial statements provided by NLC for the current year valuation and audited financial statements for the prior year valuation. Due to the nature of this investment, there is no readily determinable fair value as more fully described in Note E.

Cash and Cash Equivalents

The Fund's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date acquired by the Fund, except mutual funds and cash equivalents in the investment account held by the People's United Bank, as these are included within investments.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

The Fund's carrying amount of cash deposits and the bank balance at December 31, 2012 and 2011 were as follows:

	<u>December 31, 2012</u>		<u>December 31, 2011</u>	
	<u>Book</u>	<u>Bank</u>	<u>Book</u>	<u>Bank</u>
	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>	<u>Balance</u>
Insured/FDIC	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000
Uninsured, Collateralized by US Gov't and Agency Securities held by the People's United Bank Trust Department with a security interest granted to the Fund	<u>6,597,461</u>	<u>6,861,011</u>	<u>6,627,406</u>	<u>4,158,585</u>
Total	<u>\$ 6,847,461</u>	<u>\$ 7,111,011</u>	<u>\$ 6,877,406</u>	<u>\$ 4,408,585</u>

The difference between the book balance and the bank balance is due to reconciling items such as deposits in transit and outstanding checks, as well as petty cash on hand.

The Federal Deposit Insurance Corporation (FDIC) insures amounts on deposit up to the limits as prescribed by law. The Fund holds funds with financial institutions in excess of the FDIC insured amount, however, the Fund has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk on cash and cash equivalents.

Fund Contributions

Contributions are assessed on an individual member basis in advance of each fund year and are considered to be earned in the fund year to which they apply. Contributions are based on recommended rates that are approved by the Board and the Vermont Department of Financial Regulation (DFR). The members' contributions are calculated based on rates recommended by an independent consulting actuary and taking into account projected claims, reinsurance and operational costs. Contributions are adjusted by underwriting staff, where applicable, for individual member experience prior to renewal billing. Contributions ceded to other companies pursuant to reinsurance agreements have been reported as reinsurance expenses.

Contributions Collected in Advance

Contributions received prior to the fund year to which they apply are classified as contributions collected in advance on the statements of net position.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

Contributions Receivable

Contributions receivable consist primarily of billed premiums not yet collected. Management anticipates no uncollectible accounts, and therefore, has not established an allowance for doubtful accounts.

Losses and Loss Adjustment Expenses, Net of Reinsurance

The liability for unpaid losses and loss adjustment expenses includes case basis estimates for reported losses, plus amounts for incurred but not reported losses ("IBNR") calculated based on loss projections using the Fund's historical claim data. In establishing the liability for losses and loss adjustment expenses, the Fund utilizes the findings of an independent consulting actuary. Such reserves are presented net of reinsurance recoverable on unpaid losses and loss adjustment expenses. Reinsurance recoverables may not be collected until after such losses are paid by the Fund. Estimated amounts of salvage and subrogation are deducted from the liability for unpaid losses.

Management has recorded its reserves based on the actuary's point estimate and believes that its aggregate liability for unpaid losses and loss adjustment expenses at year end represents its best estimate, based upon the available data, for the amount necessary to cover the ultimate cost of losses. However, because of the limited population of insured risks, jury decisions, court interpretations, legislative changes, changes in the medical condition of claimants, statutorily mandated changes in benefits or the delivery of those benefits, public attitudes, and social/economic conditions such as inflation and other uncertainties, it is not presently possible to determine whether actual loss experience will conform to the assumptions used in estimating the liability. As a result, the actual liability may be significantly in excess of or less than the amount indicated in the financial statements. As adjustments to these estimates become necessary, such adjustments are reflected in current operations.

A portion of the net position has been designated as a safety margin or reserve for adverse development to increase the probability to a 90% confidence level that sufficient funds are available to cover all losses, as further described in Note J.

The liability for unpaid losses and loss adjustment expenses are recorded net of applicable reinsurance recoverable amounts. Reinsurance recoverable amounts are comprised of estimates of unpaid losses and loss adjustment expenses, which are expected to be recoverable from the Fund's reinsurers pursuant to reinsurance agreements. Such amounts have been estimated using actuarial assumptions consistent with those used to estimate the related liability for unpaid losses and loss adjustment expenses. Management believes that the reinsurance recoverable represents its best estimate of such amounts; however, as changes in the estimated ultimate liability for losses and loss adjustment expenses are determined, the estimated ultimate amount receivable from the reinsurance companies will also change. Accordingly, the ultimate receivable could be

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

significantly in excess of or less than the amount indicated in the notes to the financial statements. As adjustments to these estimates become necessary, such adjustments are reflected in current operations.

Claims Expense and Workers' Compensation State Assessment Reserve

The claims expense and workers' compensation state assessment reserve is maintained for the cost of administering claims to their conclusion, based on open claims and for the future state assessments on workers' compensation on future claim payments as of December 31, 2012 and 2011. In establishing the liability for the claims and workers' compensation state assessment reserve, the Fund utilizes the findings of an independent consulting actuary.

Reinsurance

The Fund maintains occurrence basis reinsurance agreements related to each particular line of coverage to reduce its exposure to large losses. The Fund evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize exposure to losses from reinsurer insolvencies. In preparing financial statements, management makes estimates of amounts recoverable from reinsurers, which include consideration of amounts, if any, estimated to be uncollectible by management. Management evaluated the creditworthiness of its reinsurers and determined that no valuation allowance was required as of December 31, 2012 and 2011. In the event that any or all of the reinsuring companies are unable to meet their obligations under existing agreements, the Fund remains contingently liable for such amounts.

Reinsurance recoverable on paid losses and loss adjustment expenses are presented as an asset in the accompanying statements of net position. Reinsurance recoverable on unpaid losses was \$4,456,138 and \$15,120,062 as of December 31, 2012 and 2011, respectively, and is netted against the liability for unpaid losses and loss adjustment expenses on the statements of net position.

During 2011, the Fund collected reinsurance in advance of payments for claims relating to Tropical Storm Irene. As of December 31, 2011, this amount represented \$446,410. There were no advance reinsurance payments at December 31, 2012.

Income Taxes

The Fund is incorporated as a nonprofit corporation under the Vermont Nonprofit Corporation Act. The Fund's income is tax-exempt under Internal Revenue Code Section 115, which pertains to political subdivisions. Accordingly, the accompanying financial statements do not include a provision for federal or state income taxes.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note B - Summary of Significant Accounting Policies (Continued)

Classification of Revenues and Expenses

The Fund reports itself as a business-type activity as defined in GASB 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. Business-type activities are financed in whole or in part by fees charged to external parties. Business-type activities distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Fund's enterprise fund include fund contributions (premiums) and fees received from providing services. Operating expenses include claims paid, reinsurance premiums, and the costs of providing services and operating all programs. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Reclassifications

Certain reclassifications have been made in the 2011 audited financial statements to conform to the 2012 presentation, which had no effect on net position or change in net position.

Note C - Affiliated Organizations and Related Party Transactions

The accompanying financial statements represent the general operations of the Fund and do not include the operations and financial condition of VLCT or other affiliated organizations.

VLCT provides staff, office space and equipment usage to the Fund. For the years ended December 31, 2012 and 2011, total VLCT budgeted expenses allocated to the Fund were \$2,618,904 and \$2,361,961, respectively, which amounted to 61.7% and 58.7%, respectively, of total allocable VLCT expenses. The following VLCT expenses are attributable to the Fund:

- Salary and benefits for administrative staff including finance, human resource, production and general administrative support
- Office costs including all building-related expenses and insurances
- Equipment and communications costs
- Printing and supplies
- Travel and training for administrative functions
- Non-Trust Officers costs
- Contracted services
- Dues and subscriptions for administrative staff
- Services provided for administrative activities
- Miscellaneous costs related to administrative activities

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note C - Affiliated Organizations and Related Party Transactions (Continued)

For 2012, 21% of the expenses paid were for administration and marketing, 19% for underwriting, 39% for claims handling and 21% for loss prevention.

For 2011, 21% of the expenses paid were for administration and marketing, 20% for underwriting, 37% for claims handling and 22% for loss prevention.

Note D - Investments

The Fund's investment policy, as approved by the Board, contains certain provisions and limitations intended to mitigate the Fund's exposure to various investment risks, such as credit risk (including custodial risk and concentration risk) and interest rate risk, as follows:

- *Credit risk* - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit risk is measured by an assigned rating from a nationally recognized credit rating agency such as Standard and Poor's or Moody's Rating Services. These organizations look at a number of factors in order to evaluate the credit risk of an obligation and rate the risk. This rating allows investors to make informed buying and selling decisions. The Fund's investment policy is structured with limitations and guidelines intended to mitigate the components of credit risk as summarized in the following two bullet points.
- *Custodial credit risk* - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Fund will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Neither the Vermont Statutes nor the Fund's investment policy guidelines contain requirements limiting custodial credit risk other than indicating that "prudent investment policies" should be followed. An agreement with the People's United Bank, the custodial financial institution for the investment portfolio, is in place and indemnifies the Fund against losses caused by negligence or dishonesty.
- *Concentration of credit risk* - Concentration risk is the risk of loss attributable to the magnitude of an investment in a single issuer (with the exception of U.S. Government Obligations, which have no limit) to 5%. There are no single investments that exceed this limit as of December 31, 2012 and 2011.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note D - Investments (Continued)

- *Interest rate risk* - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in interest rates. The Fund's investment policy limits the average effective duration for the portfolio to 8 years.

The following table provides a summary of the fair value of the Funds fixed-maturity security investment portfolio by contractual maturity as of December 31, 2012. The expected maturities in the following table may differ from the contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalty.

	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	Total
U.S. Treasuries	\$ 2,736,354	\$ 2,342,005	\$ 1,576,855	\$ 2,161,351	\$ 8,816,565
U.S. Agencies	-	-	-	4,325,092	4,325,092
U.S. Agency MBS	-	101,235	1,682,324	42,697	1,826,256
Corporate Bonds	241,670	3,758,893	5,649,595	8,320,836	17,970,994
Municipal Bonds	-	-	319,289	823,713	1,143,002
Foreign Bonds	-	-	-	333,990	333,990
Total	<u>\$ 2,978,024</u>	<u>\$ 6,202,133</u>	<u>\$ 9,228,063</u>	<u>\$ 16,007,679</u>	<u>\$ 34,415,899</u>

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note D - Investments (Continued)

The table below outlines the Standard and Poor's credit ratings of the Fund's fixed-maturity security investment holdings as of December 31, 2012:

	<u>U.S. Treasuries</u>	<u>U.S. Agencies</u>	<u>U.S.Agency MBS</u>	<u>Corporate Bonds</u>	<u>Municipal Bonds</u>	<u>Foreign Bonds</u>	<u>Total</u>
AAA	\$ -	\$ -	\$ -	\$ 2,293,322	\$ 406,618	\$ -	\$ 2,699,940
AA+	8,816,565	4,325,092	1,826,256	802,128	169,307	-	15,939,348
AA	-	-	-	327,427	-	-	327,427
AA-	-	-	-	487,918	247,788	-	735,706
A+	-	-	-	415,014	319,289	333,990	1,068,293
A	-	-	-	3,141,464	-	-	3,141,464
A-	-	-	-	3,817,780	-	-	3,817,780
BBB+	-	-	-	3,303,497	-	-	3,303,497
BBB	-	-	-	1,409,314	-	-	1,409,314
BBB-	-	-	-	175,242	-	-	175,242
NR	-	-	-	1,797,888	-	-	1,797,888
Total	<u>\$ 8,816,565</u>	<u>\$ 4,325,092</u>	<u>\$ 1,826,256</u>	<u>\$17,970,994</u>	<u>\$ 1,143,002</u>	<u>\$ 333,990</u>	<u>\$ 34,415,899</u>

Certain investments are considered not rated (NR) by Standard and Poor's, but are rated by Moody's and Fitch rating services as follows as of December 31, 2012:

Moody's Aaa/ Fitch AAA	\$1,587,947
Moody's Baa1/Fitch BBB+	\$146,828

One security, a Lehman Brothers bond for \$63,113, is unrated by all agencies and is being held until the bankruptcy distributions are finalized.

The effective duration is used to assess interest rate risk by estimating the sensitivity of fixed income securities to interest rate changes. The effective duration estimates the percentage change in the market value of an investment (or an investment portfolio) for a one percent change in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows for investments that are highly sensitive to interest rate changes, such as mortgage-backed securities, callable bonds and variable-rate debt.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note D - Investments (Continued)

The following were the effective durations of fixed-maturity security investments held by the Fund as of December 31, 2012:

	<u>Fair Value</u>	<u>Effective Duration</u>
U.S. Treasuries	\$ 8,816,565	6.36
U.S. Agencies	4,325,092	4.66
U.S. Agency MBS	1,826,256	2.86
Corporate Bonds	17,970,994	7.04
Municipal Bonds	1,143,002	12.24
Foreign Bonds	<u>333,990</u>	<u>8.77</u>
Total	<u>\$ 34,415,899</u>	5.88

The average effective duration of the investment portfolio as of December 31, 2012 and 2011, was 5.88 and 5.84 years, respectively.

The following table shows the classifications of the Fund's mutual fund investments as of December 31, 2012 and 2011:

<u>Classification</u>	<u>2012 Fair Value</u>	<u>2011 Fair Value</u>
Large Cap Blend	\$ 1,258,527	\$ 1,041,264
Large Cap Growth	911,406	743,591
Large Cap Value	771,892	672,886
Mid Cap Growth	990,561	869,572
Mid Cap Value	945,579	834,181
Small Cap Blend	<u>970,111</u>	<u>849,762</u>
Total	<u>\$ 5,848,076</u>	<u>\$ 5,011,256</u>

Gross realized gains and losses on the sale of investments were \$1,157,519 and \$133,639, respectively, and net unrealized gains attributable to the change in fair value of investments were \$847,607 for the year ended December 31, 2012. Gross realized gains and losses on the sale of investments were \$508,219 and \$120,038, respectively, and net unrealized losses attributable to the change in fair value of investments were \$594,768 for the year ended December 31, 2011.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note E - Investment in NLC Mutual Insurance Company

The Fund is a member of NLC, which is a Vermont captive mutual insurance company founded with the assistance of the National League of Cities to provide reinsurance to state league sponsored risk sharing pools. Members make capital contributions and pay premiums in exchange for reinsurance. An analysis of the change in the Fund's investment in NLC is as follows:

	<u>2012</u>	<u>2011</u>
Capital contribution	\$ 494,577	\$ 494,577
Accumulated equity in earnings of NLC	<u>1,615,026</u>	<u>1,531,744</u>
Total investment in NLC	<u>\$ 2,109,603</u>	<u>\$ 2,026,321</u>

The Fund recognized investment income from NLC of \$83,282 and \$87,258 for the years ending December 31, 2012 and 2011, respectively.

At the sole discretion of the Fund, an election can be made to withdraw from NLC by giving written notice. The capital and accumulated earnings of \$2,109,603 and \$2,026,321 at December 31, 2012 and 2011, respectively, will be paid to the Fund after the designated number of years selected by the Fund after the completion of the first fiscal year following the termination notice. The Fund continues to be eligible to receive distributions to its capital account until the funds are returned and the account is closed. Termination of membership does not relieve the Fund of any liabilities and obligations for any unpaid capital contributions, required additional capital or annual premium, except that required additional capital shall be limited to forfeiture of the remaining balance in the Fund's capital account. Any undistributed percentage of retained earnings shall be forfeited by the Fund. This methodology began during 2008.

Upon termination, the percentage of retained earnings distributed is as follows:

<u>No. of Years After Computation Date</u>	<u>% of Retained Earnings Distributed</u>
2	20
3	30
4	40
5	50
6	60
7	70
8	80
9	90
10	100

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note F - Contributions Receivable

All estimated contributions must be collected in accordance with the membership agreement. As of December 31, 2012 and 2011, no allowance for doubtful collection was recorded by the Fund based on management's analysis of contributions receivable. There were no write-offs of contributions receivable during 2012 and 2011.

Contributions receivable includes contributions recorded but not currently due from the City of Burlington of \$182,019 and \$248,569 at December 31, 2012 and 2011, respectively. Contributions receivable also include current receivables due from other municipalities of \$131,203 and \$175,216 at December 31, 2012 and 2011, respectively.

The agreement with the City of Burlington calls for contributions for the loss fund to be billed at a percentage of total claims up to a maximum as follows:

<u>Year</u>	<u>Percentage</u>	<u>Maximum</u>
1992	29.40 %	\$ 312,500
1993	29.40 %	\$ 562,108
1994	25.00 %	\$ 608,548
1995	20.00 %	\$ 620,923
1996	18.00 %	\$ 729,481
1997	14.86 %	\$ 579,570
1998	18.60 %	\$ 725,276
1999	19.50 %	\$ 760,590
2000	20.47 %	\$ 818,947
2001	21.82 %	\$ 1,069,180
2002	21.28 %	\$ 1,138,664
2003	16.44 %	\$ 1,145,589
2004	13.86 %	\$ 1,067,143
2005	14.90 %	\$ 1,191,920
2006	13.60 %	\$ 1,219,607

Fund years 1992, 1993, 1996 through 2000, 2002, 2004 and 2005 currently have no receivables outstanding at December 31, 2012, as they have reached the maximum.

Note G - Liability for Unpaid Losses, Net of Reinsurance

As discussed in Note B, the Fund establishes an estimated liability for unpaid losses for both reported and unreported insured events, which include estimates of both future payments of losses and related claim adjustment expenses. This liability for unpaid losses is estimated by an independent actuary based on claims information as of December 31, as well as assumptions for changes in membership and insurance product offerings. The Fund does not discount its loss reserves.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note G - Liability for Unpaid Losses, Net of Reinsurance (Continued)

The components of the liability for losses and loss adjustment expenses and related reinsurance receivable are as follows at December 31:

	<u>2012</u>	<u>2011</u>
Case-basis reserves	\$ 16,504,655	\$ 24,170,232
IBNR reserves	<u>8,872,521</u>	<u>6,050,667</u>
Gross reserves	25,377,176	30,220,899
Reinsurance recoverable on unpaid losses	<u>(4,456,138)</u>	<u>(15,120,062)</u>
Net reserves	20,921,038	15,100,837
Claims expense and WC state assessment reserve	<u>1,462,818</u>	<u>1,172,315</u>
Total net reserves	<u>\$ 22,383,856</u>	<u>\$ 16,273,152</u>

The following represents changes in the liability for unpaid losses and loss adjustment expenses, net of the effects of reinsurance, during the years ended December 31:

	<u>2012</u>	<u>2011</u>
Liability at beginning of year, net of reinsurance recoverable of \$15,120,062 and \$4,332,410	\$ 16,273,152	\$ 16,320,704
Provision for losses:		
Provision for insured events of the current year	10,072,389	9,623,411
Increase in provision for insured events of prior years	<u>5,026,408</u>	<u>46,112</u>
Total provision for losses during the year	<u>15,098,797</u>	<u>9,669,523</u>
Payments:		
Claims and claims adjustment expenses attributable to insured events of the current year	2,501,075	4,132,562
Claims and claims adjustment expenses attributable to insured events of the prior years	<u>6,487,018</u>	<u>5,584,513</u>
Total payments during the year	<u>8,988,093</u>	<u>9,717,075</u>
Liability at end of year, net of reinsurance recoverable of \$4,456,138 and \$15,120,062	<u>\$ 22,383,856</u>	<u>\$ 16,273,152</u>

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note G - Liability for Unpaid Losses, Net of Reinsurance (Continued)

During 2012, the Fund experienced unfavorable loss development of prior years related to the 2003, 2005-2008, 2010 and 2011 workers' compensation, 2008 auto liability and 2004, 2009 and 2011 property coverages. The unfavorable development was partially offset by favorable development related to the 2009 workers' compensation and 2005 and 2010 general liability coverages. During 2011, the Fund experienced unfavorable loss development of prior years related to the 2010 workers' compensation and law enforcement, 2008 auto liability and 2006 general liability coverages, which was partially offset by favorable development related to the 2009 and 2006 workers' compensation and 2007-2010 general liability coverages.

Note H - Insurance Activity

Since its inception, the Fund has maintained various quota-share and excess of loss reinsurance agreements to limit its exposure to large claims. Such reinsurance reduces the magnitude of sudden and unpredictable changes in net position; however, the Fund remains contingently liable should the reinsurers fail for any reason to perform their obligations under the agreements.

Reinsurance in place is as follows:

Line of Coverage	Reinsurance Term	Fund Retention	Policy Limit
Property	1/1/2009-1/1/2013	\$500,000	\$500,000,000
	1/1/2005-1/1/2009	\$150,000	\$500,000,000
	1/1/1996-1/1/2005	\$150,000	\$50,000,000
Flood and Earthquake	1/1/2012-1/1/2013	\$500,000	\$50,000,000
Casualty	1/1/2011-1/1/2013	\$500,000	\$10,000,000
	1/1/2010-1/1/2011	\$500,000	\$5,000,000
	1/1/2005-1/1/2010	\$500,000	\$2,000,000
	1/1/1996-1/1/2005	\$250,000	\$2,000,000
Workers' Compensation	1/1/2006-1/1/2013	\$500,000	Statutory/\$5,000,000
	1/1/2005-1/1/2006	\$350,000	Statutory/\$5,000,000
	1/1/1996-1/1/2005	\$250,000	Statutory/\$5,000,000
Boiler & Machinery	1/1/1996-1/1/2013	\$100,000	\$50,000,000

Amounts in excess of the Fund's retentions are ceded to various reinsurers up to various policy limits which also contain various sublimits.

For the years ended December 31, 1998-2000, the Fund maintained a quota-share reinsurance agreement with NLC for 50% participation applied to all lines of business. Effective January 1, 2011, NLC takes 100% of the \$500,000 xs \$500,000 layer for property coverage. Reinsurance recoverable from NLC amounted to \$48,731 and \$57,950 at December 31, 2012 and 2011, respectively.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note I - Line of Credit

During 2011, the Fund entered into an agreement with People's United Bank for a \$5,000,000 line of credit with interest being charged at the Prime Rate less 0.75%, with a floor of 0%. The line is secured by the Fund's cash and investments. There have been no borrowings under this agreement.

Note J - Net Position

In accordance with laws of the State of Vermont ("the State"), for the purpose of submitting financial statements to the State for regulatory purposes, the Fund is required to use GAAP with the exception of variances prescribed by Vermont laws and regulations or permitted by the Vermont Department of Financial Regulation ("the Department").

Net position accrues to the benefit of the participants as earned. Any funds not needed to pay claims and maintain prudent reserves will be available for distribution to the members or credited toward future member contributions, as determined by the Board. Alternately, the Board and management of the Fund may increase retentions on reinsurance policies or offer additional services to the members. The Board has elected to designate a portion of the net position to increase the probability to a ninety percent (90%) confidence level that sufficient funds are available to cover all losses. This amount has been estimated by the Fund's actuary and has been discounted to account for the significant time difference between the collection of premiums and the payment of claims. The amount designated for this purpose at December 31, 2012 and 2011 was \$1,339,360 and \$1,045,499, respectively.

Per State regulation, no distribution of the surplus funds shall be made earlier than twenty-four (24) months, without approval from the Commissioner, following the end of the Fund's fiscal year for which a surplus was declared. Such distribution shall not be made until certified by an actuary. If the distribution is in excess of 10% of the Fund's surplus, it shall be considered an extraordinary distribution and shall require prior approval of the Department. Application for the extraordinary distribution shall be submitted to the Department for approval and certified by an actuary.

The Board has restricted funds for premium credits and the safety grant program, based on actuarial recommendation, for certain prior fund years. The credits are applied towards subsequent fund year premium contributions and expensed as member distributions-contribution credit on the statement of contributions, expenses and changes in net position. The member safety grant expenses are included in general and administrative expenses.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Notes to the Financial Statements (Continued)

Note J - Net Position (Continued)

Distributions from the fund years were allocated as follows:

<u>Year</u>	<u>2013 Credits</u>	<u>2012 Credits</u>	<u>2011 Credits</u>
2002	\$ -	\$ -	\$ 58,194
2003	94,857	156,324	201,903
2006	113,726	216,188	222,157
2007	260,672	271,453	268,411
2008	226,546	374,619	249,335
2009	235,729	481,416	-
2010	268,470	-	-
Total	<u>\$ 1,200,000</u>	<u>\$ 1,500,000</u>	<u>\$ 1,000,000</u>

Distributions were allocated between contribution credits and member safety as follows:

	<u>2013 Credits</u>	<u>2012 Credits</u>	<u>2011 Credits</u>
Amounts approved for contribution credits	\$ 1,000,000	\$ 1,250,000	\$ 800,000
Member safety grant program	<u>200,000</u>	<u>250,000</u>	<u>200,000</u>
Total funds applied	<u>\$ 1,200,000</u>	<u>\$ 1,500,000</u>	<u>\$ 1,000,000</u>

Note K - Commitments and Contingencies

The Fund is involved in various claims and legal actions arising in the ordinary course of business, which are considered in the estimate of the liability for losses and loss adjustment expenses.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Claims Development Information (unaudited)

December 31, 2012

This table illustrates how the Fund's earned revenues (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Fund as of the end of each of the last ten years.

The rows of the table are defined as follows:

1. This line shows the gross of each fiscal year's earned contribution revenues and investment revenues
2. This line shows each fiscal year's reinsurance premiums (ceded contributions).
3. This line shows the net of each fiscal year's earned contribution revenues and investment revenues.
4. This line shows each fiscal year's other operating costs of the Fund including overhead.
5. This line shows the Fund's incurred claims and allocated claim adjustment expense (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called policy year).
6. This section of rows shows the cumulative amounts paid as of the end of successive years for each policy year.
7. This section of rows shows how each policy year's incurred claims increased or decreased as of the end of successive years. This annual re-estimation results from new information received on known claims, reevaluation of existing information on known claims as well as emergence of new claims not previously known.
8. This line compares the latest re-estimated incurred claims amount to the amount originally established (line 5) and shows whether this latest estimate of claims cost is greater or less than originally thought.

The columns of the table show data for successive policy years.

VLCT Property and Casualty Intermunicipal Fund, Inc.

Claims Development Information (unaudited)

December 31, 2012

	Fiscal and Policy Year Ended (in thousands of dollars)									
	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
(1) Gross contributions and investment income	\$ 18,128	\$ 17,782	\$ 18,563	\$ 17,648	\$ 16,437	\$ 15,347	\$ 16,029	\$ 14,739	\$ 13,149	\$ 12,596
(2) Less: Reinsurance expenses	3,341	2,677	2,984	2,690	2,805	2,523	2,783	2,512	2,308	1,981
(3) Net earned premiums and investment income	14,787	15,105	15,579	14,958	13,632	12,824	13,246	12,227	10,841	10,615
(4) Unallocated expenses	3,910	3,545	3,501	3,506	3,614	3,008	2,927	2,649	2,296	2,297
(5) Estimated losses and allocated expenses incurred, net at the end of year:	10,072	9,623	8,363	8,461	8,250	9,411	9,423	8,583	7,563	6,764
(6) Net paid (cumulative) as of:										
End of policy year	2,501	4,133	3,131	2,646	2,509	2,881	2,321	2,689	2,584	2,048
One year later		6,714	5,054	5,214	4,432	4,848	5,044	5,719	4,648	4,101
Two years later			6,492	6,283	5,162	5,985	6,478	7,497	5,843	5,242
Three years later				7,140	5,859	6,566	7,390	8,574	7,019	5,988
Four years later					6,943	6,943	7,681	9,183	7,759	6,396
Five years later						7,253	8,436	9,962	8,805	6,643
Six years later							8,673	10,482	9,047	6,732
Seven years later								10,154	9,153	6,791
Eight years later									9,270	6,816
Nine years later										6,832
(7) Reestimated net incurred losses and allocated expenses										
End of policy year	10,072	9,623	8,363	8,461	8,250	9,411	9,423	8,583	7,563	6,764
One year later		10,781	8,678	9,014	7,849	7,943	9,213	10,227	7,731	6,672
Two years later			9,981	8,483	7,448	7,406	9,311	10,291	7,888	6,644
Three years later				9,268	7,802	8,094	9,209	10,801	8,474	6,792
Four years later					9,242	7,759	9,037	10,801	8,565	6,830
Five years later						8,013	9,016	10,643	9,238	7,050
Six years later							9,278	10,695	9,310	7,031
Seven years later								10,363	9,284	7,068
Eight years later									9,389	7,046
Nine years later										7,072
(8) Increase (decrease) in estimated net incurred losses and allocated expenses from end of policy year	\$ -	\$ 1,158	\$ 1,618	\$ 807	\$ 992	\$ (1,398)	\$ (145)	\$ 1,780	\$ 1,826	\$ 308

* During 2012, the 2011 numbers were updated to reflect actual results

VLCT Property and Casualty Intermunicipal Fund, Inc.

Reconciliation of Claim Liabilities by Type of Contract (unaudited)

December 31, 2012

	<u>Workers' Compensation</u>		<u>Property and Casualty Lines</u>		<u>Total</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Reserve for losses and LAE at beginning of year, net of reinsurance	\$ 10,031,324	\$ 10,220,688	\$ 6,241,828	\$ 6,100,016	\$ 16,273,152	\$ 16,320,704
Losses and LAE incurred relating to:						
Current year	4,300,201	3,356,895	5,772,188	6,266,516	10,072,389	9,623,411
Prior years	<u>3,595,858</u>	<u>1,161,386</u>	<u>1,430,550</u>	<u>(1,115,274)</u>	<u>5,026,408</u>	<u>46,112</u>
Total losses and LAE incurred	<u>7,896,059</u>	<u>4,518,281</u>	<u>7,202,738</u>	<u>5,151,242</u>	<u>15,098,797</u>	<u>9,669,523</u>
Losses and LAE paid relating to:						
Current year	1,338,942	1,463,505	1,162,133	2,669,057	2,501,075	4,132,562
Prior years	<u>3,770,461</u>	<u>3,244,140</u>	<u>2,716,557</u>	<u>2,340,373</u>	<u>6,487,018</u>	<u>5,584,513</u>
Total losses as LAE paid	<u>5,109,403</u>	<u>4,707,645</u>	<u>3,878,690</u>	<u>5,009,430</u>	<u>8,988,093</u>	<u>9,717,075</u>
Reserve for losses and LAE at end of year, net of reinsurance	<u>\$ 12,817,980</u>	<u>\$ 10,031,324</u>	<u>\$ 9,565,876</u>	<u>\$ 6,241,828</u>	<u>\$ 22,383,856</u>	<u>\$ 16,273,152</u>

VLCT Property and Casualty Intermunicipal Fund, Inc.

Combining Statement of Net Position (unaudited)

December 31, 2012

	Surplus Reserve Fund	2012 Fund Year	2011 Fund Year	1992 - 2010 Fund Year	Total
Assets					
Fixed-maturity securities, at fair value	\$ 22,611,719	\$ -	\$ 312,312	\$ 11,491,868	\$ 34,415,899
Mutual funds, at fair value	-	-	-	5,848,076	5,848,076
Investment in NLC Mutual Insurance Company	<u>2,109,603</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,109,603</u>
Total Investments	24,721,322	-	312,312	17,339,944	42,373,578
Cash and cash equivalents	(7,040,668)	11,234,015	3,759,104	(1,104,990)	6,847,461
Accrued investment income	184,025	-	37,743	74,513	296,281
Contributions Receivable	-	118,561	12,642	182,019	313,222
Accounts receivable - deductibles and subrogation	-	-	-	-	-
Prepaid expenses	-	871,899	26,196	-	898,095
Reinsurance recoverable - paid losses	-	-	-	650,630	650,630
Other assets	<u>276,221</u>	<u>-</u>	<u>230,471</u>	<u>-</u>	<u>506,692</u>
Total Assets	<u>\$ 18,140,900</u>	<u>\$ 12,224,475</u>	<u>\$ 4,378,468</u>	<u>\$ 17,142,116</u>	<u>\$ 51,885,959</u>
Liabilities					
Losses and loss adjustment expenses, net of reinsurance	\$ -	\$ -	\$ 3,751,544	\$ 17,169,494	\$ 20,921,038
Accounts payable	-	-	19,474	272,472	291,946
Net subrogation and reinsurance payable	-	-	(87,119)	452,143	365,024
Contributions collected in advance	-	4,627,046	-	-	4,627,046
Reinsurance collected in advance	-	-	-	-	-
Claims expense and workers' compensation state assessment reserve	-	-	316,008	1,146,810	1,462,818
Total Liabilities	-	4,627,046	3,999,907	19,040,919	27,667,872
Net Position					
Restricted	-	-	-	1,200,000	1,200,000
Unrestricted	<u>18,140,901</u>	<u>4,327,591</u>	<u>738,640</u>	<u>(189,045)</u>	<u>23,018,087</u>
Total Net Position	<u>18,140,901</u>	<u>4,327,591</u>	<u>738,640</u>	<u>1,010,955</u>	<u>24,218,087</u>
Total Liabilities and Net Position	<u>\$ 18,140,901</u>	<u>\$ 8,954,637</u>	<u>\$ 4,738,547</u>	<u>\$ 20,051,874</u>	<u>\$ 51,885,959</u>

VLCT Property and Casualty Intermunicipal Fund, Inc.

Combining Statement of Contributions, Expenses and Change in Net Position
(unaudited)

December 31, 2012

	Surplus <u>Reserve Fund</u>	2012 <u>Fund Year</u>	2011 <u>Fund Year</u>	1992 - 2010 <u>Fund Year</u>	<u>Total</u>
Operating Revenues					
PC contributions	\$ -	\$ 11,836,128	\$ 522	\$ -	\$ 11,836,650
WC contributions	-	6,701,763	(11,692)	-	6,690,071
Other income	-	15,750	-	-	15,750
	<u>-</u>	<u>18,553,641</u>	<u>(11,170)</u>	<u>-</u>	<u>18,542,471</u>
Total operating (expenses) revenues	-	18,553,641	(11,170)	-	18,542,471
Operating expenses					
Losses and loss adjustment expenses, net of reinsurance	-	10,072,389	1,158,382	3,868,026	15,098,797
General and administrative expenses	18,809	3,909,630	55,421	6,003	3,989,863
Reinsurance expenses	-	-	7,564	3,885,507	3,893,071
Broker fees for reinsurance	-	123,787	-	-	123,787
	<u>18,809</u>	<u>14,105,806</u>	<u>1,221,367</u>	<u>7,759,536</u>	<u>23,105,518</u>
Total operating expenses	18,809	14,105,806	1,221,367	7,759,536	23,105,518
Operating (loss) income	(18,809)	4,447,835	(1,232,537)	(7,759,536)	(4,563,047)
Non-operating revenues (expenses)					
Investment income - interest and dividends	944,687	3,865	213,492	266,559	1,428,603
Investment income - net change in fair value	752,742	-	31,896	62,969	847,607
Net realized gains	703,530	-	107,708	212,642	1,023,880
Investment income - NLC Insurance Company	83,282	-	-	-	83,282
Investment management fees	-	(124,109)	-	-	(124,109)
	<u>2,484,241</u>	<u>(120,244)</u>	<u>353,096</u>	<u>542,170</u>	<u>3,259,263</u>
Net non-operating revenues	2,484,241	(120,244)	353,096	542,170	3,259,263
Member contributions - contribution credit	-	-	-	1,250,007	1,250,007
	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,250,007</u>	<u>1,250,007</u>
Non-operating income (loss)	2,484,241	(120,244)	353,096	(707,837)	2,009,256
Change in net position	2,465,432	4,327,591	(879,441)	(8,467,373)	(2,553,791)
Net position, beginning of year	15,675,469	-	1,618,081	9,478,328	26,771,878
	<u>15,675,469</u>	<u>-</u>	<u>1,618,081</u>	<u>9,478,328</u>	<u>26,771,878</u>
Net position, end of year	\$ 18,140,901	\$ 4,327,591	\$ 738,640	\$ 1,010,955	\$ 24,218,087
	<u>\$ 18,140,901</u>	<u>\$ 4,327,591</u>	<u>\$ 738,640</u>	<u>\$ 1,010,955</u>	<u>\$ 24,218,087</u>

VLCT Property and Casualty Intermunicipal Fund, Inc.

Schedule of General and Administrative Expenses (unaudited)

December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
VLCT Administration	\$ 2,618,904	\$ 2,361,961
Data System	302,446	287,453
Consulting Services	46,364	14,534
Actuarial Services	55,354	42,805
Legal Services	2,655	3,375
Accounting	93,684	52,212
Banking Costs	28,654	28,510
Investment Consulting Fees	-	-
Insurance	40,332	40,550
Board of Trustees	22,943	23,871
Staff Training	42,283	32,019
Trustee Training	-	-
Vehicles	60,037	65,587
Printing	5,293	4,682
Member Training	200,238	135,259
Drug and Alcohol	56,839	65,366
Wellness	138,630	155,099
Promotions	254,429	240,170
Dues and Subscriptions	19,677	17,290
Town Fair	850	768
Miscellaneous	<u>251</u>	<u>6,308</u>
Total	<u>\$ 3,989,863</u>	<u>\$ 3,577,819</u>