PERAC
COMMONWEALTH OF MASSACHUSETTS | PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION COMMISSION

M E M O R A N D U M

TO: Somerville Retirement Board

FROM: Joseph E. Connarton, Executive Director

RE: Approval of Funding Schedule

DATE: December 14, 2015

This Commission is hereby furnishing you with approval of the revised funding schedule you recently adopted (copy enclosed). This schedule is based on the results of your January 1, 2015 actuarial valuation. The schedule is effective in FY16 (since the FY16 amount under the prior schedule was maintained).

Although we are approving this schedule, note that in each our last three funding schedule approval memorandums (February 18, 2014, September 19, 2011 and August 12, 2009), we outlined a number of concerns regarding funding levels and the actuarial assumptions. The most recent valuation uses the same principal assumptions as the prior valuation. Consequently, we will reiterate our concerns.

Our goal in designing funding schedules is to maintain, as much as possible, budgeted appropriation amounts in both good times and bad. The System can much easier "weather the storm" by maintaining the level of its budgeted appropriation. The significant reduction to the FY10 and each subsequent year's appropriation has reduced the System's flexibility in the event of a market downturn. The FY17 appropriation in this updated schedule remains $1.5 million less than that outlined in the 2007 schedule despite 8.0% appropriation increases in FY15 and FY16. The 2007 schedule was in place prior to the FY10 reduction of approximately $1.85 million.

In addition, the actuarial assumptions are the least conservative of any system subject to Chapter 32. The Board maintained an investment return assumption of 8.25% in this valuation. We recommended in our prior memorandums that this assumption be reduced. The 8.25% assumption is the highest of any Chapter 32 plan and only 6 systems are using this assumption. As of January 1, 2013, PERAC reduced its "standard" investment return assumption for local system valuations to 7.75%. In our January 1, 2015 valuations, we generally recommended a further reduction. There are now 78 systems currently using an assumption less than 8.0%. Of these, 25 are using an assumption less than 7.75%.

The 3.0% salary increase assumption is also among the lowest of any Chapter 32 system. PERAC's current standard assumption (ultimate rate after 10 years of service) ranges from 4.25% for Group 1 members to 4.75% for Group 4 members. We note the valuation report shows a loss on salary (salary was greater than expected) of $1.1 million. We expect that over the long term this assumption will need to be increased (and/or the investment return assumption decreased) which will increase plan liabilities.

We also recommend boards adopt a fully generational mortality assumption. A fully generational assumption includes future mortality improvement (longer life expectancy). Currently 51 systems have adopted such an assumption.

The combination of the high investment return assumption, low salary increase assumption, and the static mortality assumption provides no conservatism for the System. Our preferred approach would have been to use a more conservative assumption set, increase the FY17 and FY18 appropriations to at least the level of the 2013 schedule, and extend the schedule a few years if necessary. Note that the revised schedule has the unfunded actuarial liability fully amortized by FY34. However, adopting a more conservative assumption set would likely extend the schedule beyond FY35. We believe a funding date of FY35 should be a top priority.

Our understanding is the City generally makes appropriation payments in two equal installments in July and November/December while the Housing Authority makes its appropriation payments monthly from July through December. The revised schedule adopted by the Board assumes a payment date of July 1. If the schedule were to properly reflect the actual timing of the payments, the schedule would need to be extended slightly if the payments in the schedule already adopted were not adjusted. We discussed this same issue in the 2013 approval. Please discuss this issue with your actuary before the next actuarial valuation so that the next schedule reflects the assumed payment dates.

We understand you will be performing an experience study in the next year. However, we do not expect that study will change our recommendations outlined in this memorandum. We are available to meet to discuss these issues further. If you have any questions, please contact PERAC's Actuary, Jim Lamenzo, at (617) 666-4446, extension 921.

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Appropriation Forecast

Fiscal Year Ending	Payroll*	Employee Contribution	Employer Normal Cost with Interest	Amortization Payments with Interest	Employer Total Cost with Interest	Employer Total Cost % of Payroll	Funded Ratio %**
2016	$66,506,738	$5,799,541	$2,713,670	$11,485,857	$14,199,527	21.4	62.5
2017	$69,167,008	$6,093,073	$2,758,177	$11,901,257	$14,659,434	21.2	63.4
2018	$71,242,018	$6,339,263	$2,774,962	$12,336,957	$15,111,919	21.2	64.6
2019	$73,379,278	$6,594,740	$2,790,272	$12,641,921	$15,432,193	21.0	65.9
2020	$75,580,657	$6,859,840	$2,804,002	$12,483,144	$15,287,146	20.2	67.3
2021	$77,848,076	$7,134,911	$2,816,046	$12,590,465	$15,406,511	19.8	68.5
2022	$80,183,519	$7,420,312	$2,826,288	$13,094,084	$15,920,372	19.9	69.8
2023	$82,589,024	$7,716,416	$2,834,610	$13,617,847	$16,452,457	19.9	71.1
2024	$85,066,695	$8,023,608	$2,840,888	$14,162,561	$17,003,449	20.0	72.6
2025	$87,618,696	$8,342,287	$2,844,992	$14,729,064	$17,574,056	20.1	74.2
2026	$90,247,257	$8,672,865	$2,846,785	$15,318,226	$18,165,011	20.1	76.0
2027	$92,954,674	$9,015,770	$2,846,125	$15,930,955	$18,777,080	20.2	77.9
2028	$95,743,315	$9,371,444	$2,842,863	$16,568,193	$19,411,056	20.3	80.0
2029	$98,615,614	$9,740,344	$2,836,844	$17,230,921	$20,067,765	20.3	82.3
2030	$101,574,082	$10,122,943	$2,827,906	$17,920,158	$20,748,064	20.4	84.8
2031	$104,621,305	$10,519,733	$2,815,878	$18,636,964	$21,452,842	20.5	87.4
2032	$107,759,944	$10,931,218	$2,800,583	$19,382,443	$22,183,026	20.6	90.3
2033	$110,992,742	$11,357,926	$2,781,836	$20,157,741	$22,939,577	20.7	93.4
2034	$114,322,525	$11,800,397	$2,759,444	$20,964,050	$23,723,494	20.8	96.6
2035	$117,752,200	$12,259,195	$2,733,205	$0	$2,733,205	2.3	100.0
2036	$121,284,766	$12,734,900	$2,702,908	$0	$2,702,908	2.2	100.0
2037	$124,923,309	$13,116,947	$2,783,995	$0	$2,783,995	2.2	100.0
2038	$128,671,009	$13,510,456	$2,867,515	$0	$2,867,515	2.2	100.0
2039	$132,531,139	$13,915,770	$2,953,540	$0	$2,953,540	2.2	100.0
2040	$136,507,073	$14,333,243	$3,042,146	$0	$3,042,146	2.2	100.0
2041	$140,602,285	$14,763,240	$3,133,411	$0	$3,133,411	2.2	100.0
2042	$144,820,354	$15,206,137	$3,227,413	$0	$3,227,413	2.2	100.0
2043	$149,164,964	$15,662,321	$3,324,235	$0	$3,324,235	2.2	100.0
2044	$153,639,913	$16,132,191	$3,423,962	$0	$3,423,962	2.2	100.0
2045	$158,249,111	$16,616,157	$3,526,681	$0	$3,526,681	2.2	100.0
2046	$162,996,584	$17,114,641	$3,632,482	$0	$3,632,482	2.2	100.0
2047	$167,886,482	$17,628,081	$3,741,456	$0	$3,741,456	2.2	100.0

* Calendar basis ** Beginning of Fiscal Year