

CITY OF ANNAPOLIS POLICE & FIRE RETIREMENT COMMISSION

c/o Finance Department, City of Annapolis
160 Duke of Gloucester St.
Annapolis, MD 21401

February 13, 2012

BY ELECTRONIC DELIVERY

To the Honorable Members of the City Council
City of Annapolis, MD

Re: City of Annapolis Police and Fire Retirement Commission

Ladies and Gentlemen:

As Chairman of the City of Annapolis Police and Fire Retirement Commission, I am writing to express our concern relating to the funding of the City of Annapolis Police and Fire Retirement Plan Trust (the "Trust"). This follows our earlier expression of concern communicated by letter dated May 3, 2011. We have received the actuarial valuation report as of July 1, 2011. It reinforces the concern that we earlier expressed, the Pension Board can not earn the way out of the funding deficit. The City's contribution must be increased.

There are three events that account for the current underfunding. First, the City assumed it would prevail in the litigation concerning the participants' rights to COLA payments. This alone accounts for a \$6.2 million of charges to the liabilities of the Plan.

Second, despite knowledge of the unfunded cost associated with the Court's decision, the City provided early retirement incentives to certain members who were at or near retirement age (this increased liabilities by an estimated \$2.1 million more than anticipated). While this action may save the City money by reducing employment costs in the short run, the savings were obtained at the cost of the Plan.

The third event affecting the funding of the Plan is the policy of the Federal Reserve. While we hope the actuarial assumptions---particularly the earnings assumption---are realized, we all need to recognize that the Federal Reserve has announced its commitment to maintain low interest rates. This Fed policy will make it even more difficult to realize our earnings assumption in the short run as we anticipate lower returns from our fixed income investments. The only responsible response is for the City to deposit the amount required to pay for the COLA benefits and the early retirement program that were not previously funded but have already been paid from the Trust. This approach will allow the funding of the Plan to return to a normal level, consistent with past history.

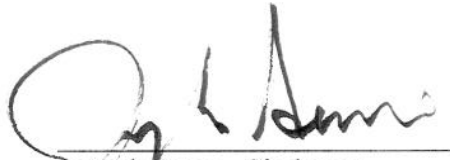
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As we previously explained, we are proud of the achievements of our investment program. While the Trust is not---and has not been---immune from broad market experience, we have achieved solid investment returns by diversifying the investments among asset classes and managers, always with concern that we minimize the risk of market losses.

While we have recovered much of the losses suffered in 2008-2009, we will not be able to fund the shortfall through investment gains. We will not expose the Plan to unreasonable investment risk in hopes of offsetting the shortage of contributions. Moreover, failure of the City to have an adequate funding program could interfere with our investment program if we are forced to provide substantial liquidity to make benefit payments. Neither of these scenarios is good for the Trust or for the City.

For the foregoing reasons we respectfully urge the Council to provide for a one-time City contribution to the Trust in the amount of \$8,300,000.

Respectfully,



Joseph Semo, Chairman

cc: The Hon. Joshua J. Cohen, Mayor
Members of the City of Annapolis
Police and Fire Retirement Commission