

**CITY OF ANN ARBOR
EMPLOYEES' RETIREMENT SYSTEM**

FINANCIAL STATEMENTS

Fiscal Years Ended June 30, 2009 and 2008



Issued by: Retirement System, 532 S. Maple Rd, Ann Arbor, Michigan 48103
(734) 794-6710

City of Ann Arbor
Employees' Retirement System

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INDEPENDENT AUDITOR'S REPORT

To the Members of the Audit Committee
City of Ann Arbor Employees' Retirement System
Ann Arbor, Michigan

We have audited the accompanying statement of plan net assets of the City of Ann Arbor Employees' Retirement System as of June 30, 2009 and 2008, and the related statement of changes in plan net assets for the years then ended. These financial statements are the responsibility of the City of Ann Arbor Employees' Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the City of Ann Arbor Employees' Retirement System and do not purport to, and do not present fairly the financial position of the City of Ann Arbor, Michigan, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the City of Ann Arbor Employees' Retirement System as of June 30, 2009 and 2008, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and historical pension information, as identified in the table of contents, are not required parts of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

ABRAHAM & GAFFNEY, P.C.
Certified Public Accountants

November 18, 2009

City of Ann Arbor
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2009 and 2008

The following is a discussion and analysis of the financial performance and position of the City of Ann Arbor Employees' Retirement System's (CAAERS). It is intended to provide an overview of CAAERS' financial activities for the fiscal years ended June 30, 2009 and 2008. This analysis should be read in conjunction with the *Independent Auditors Report* and with the financial statements, which follows this section.

Using this Annual Report

This annual report consists of three parts: (1) management's discussion and analysis (this section), (2) the financial statements, and (3) required supplementary information. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the financial statements.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Year Ended June 30,	
	<u>2009</u>	<u>2008</u>
Total assets	\$ 335,818,992	\$ 412,765,245
Total liabilities	<u>14,654,879</u>	<u>2,348,549</u>
Assets held in trust for pension benefits	<u>\$ 321,164,113</u>	<u>\$ 410,416,696</u>
Net investment (loss)	\$(80,536,700)	\$(24,756,505)
Contributions:		
Plan members	2,815,347	2,725,883
Employer	<u>14,725,702</u>	<u>7,517,024</u>
Total contributions	<u>17,541,049</u>	<u>10,242,907</u>
Retiree pension benefits	24,983,516	23,975,916
Refunds of member contributions	<u>632,944</u>	<u>375,563</u>
Total benefits paid	<u>25,616,460</u>	<u>24,351,479</u>
Benefits paid in excess of contributions	8,075,411	14,108,572
General and administrative expenses	<u>640,473</u>	<u>633,918</u>
Net (decrease) in net assets held in trust	<u>\$(89,252,584)</u>	<u>\$(39,498,995)</u>
Ratio of benefits paid to contributions	146%	238%

City of Ann Arbor
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2009 and 2008

Overall Fund Structure and Objectives

CAAERS was established to provide retirement, disability, and death benefits to general, police, and firefighter retirees and their beneficiaries. Active members earn service credit that entitles them to receive benefits in the future. Benefits currently being paid are significantly greater than contributions currently being received. The excess of benefits over contributions must be funded through investment income. The public capital markets represent the primary source of investments.

Asset Allocation

It is the responsibility of the CAAERS Board to determine the allocation of assets among distinct capital markets in accordance with allowable legal limits. Based on an asset allocation review conducted in 2007, which analyzed the expected returns of various asset classes, the Plan's actuarial assumption rate, and the risks associated with alternative asset mix strategies, the Board has established the following asset allocation:

<u>Asset Class</u>	<u>Target</u>	<u>Range</u>
Large Capitalization Domestic Equity	24.5%	+/- 5%
Mid Capitalization Domestic Equity	16%	+/- 5%
Small Capitalization Domestic Equity	12%	+/- 5%
International Equity	10%	+/- 3%
Bonds	23.5%	+/- 3%
Real Estate	10%	- 3%
Stable Value	4%	+/- 1%

The study has shown that this asset mix offers the optimal mix for meeting longer term goals. The asset classes stated above shall be further diversified (where possible) as to style and manager type to reduce risk further, while providing the opportunity for enhanced return.

Economic Factors, Investment Returns, and Other Important Matters

By most estimates the current recession has been the longest and most severe in the United States since the Great Depression. Current data indicated that the U.S. completed its eighteenth month of economic contraction in June with a decline of 3.1% in Gross Domestic Product from the peak in December 2007. At the end of the second quarter unemployment rate was 9.4% the highest since the early 80's. Most economists forecasted rates to peak near the end of the year above 10%. With the devaluation of the U.S. dollar in recent years, several foreign nations have suggested that they would like to reduce their currency risk by shifting from U.S. dollars. Investors continued to favor higher yielding securities, looking for inflation protection and unwinding the flight to quality that occurred during the fourth quarter of 2008.

The stock market is the principal investment forum utilized by CAAERS. It is important to note that CAAERS' purpose is to provide long-term benefit payments to its members and it is through long-term investing that these promised benefits will be primarily funded. However, it is recognized that in the short term there will be market fluctuations that may result in negative returns for any given period. Such is the case for 2008-2009 which shows a (18.82%) return for the year. Through its investment policy asset allocation, the Board positions the portfolio for the long-term investment objective to provide benefit payments to its members. In addition, to further maximize investment returns, management carefully monitors the performance of each of its investment managers and takes the necessary corrective action to ensure acceptable investment results.

Since CAAERS receives the majority of its new funding from its plan sponsor, the City of Ann Arbor's annual contribution is critical for the System's long-term viability. The City annually ensures that this actuarially computed amount is paid into CAAERS.

City of Ann Arbor
Employees' Retirement System

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2009 and 2008

Contacting the System's Financial Management

This financial report is designed to provide the public, citizens, and other interested parties with a general overview of CAAERS' finances and to show accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City of Ann Arbor Employees' Retirement System administrative offices at 532 S Maple Rd, Ann Arbor, Michigan 48103. The telephone number is (734) 794-6710.

City of Ann Arbor
Employees' Retirement System

STATEMENT OF PLAN NET ASSETS

June 30, 2009 and 2008

(amounts expressed in thousands)

	2009	2008
ASSETS		
Cash	\$ 3,721	\$ 1,275
Receivables		
Interest and dividends	925	979
Due from the City of Ann Arbor	11,882	235
Total receivables	12,807	1,214
Investments, at fair value		
Short term investments	13,437	6,743
U.S. government obligations	25,398	41,746
Municipal bonds	-	670
Collateralized mortgage obligations	1,706	-
Guaranteed investment contracts	13,839	13,449
Domestic and foreign corporate bonds	41,843	36,800
Domestic and foreign stocks	195,366	264,891
Real estate - direct and funds	27,245	45,989
Total investments	318,834	410,288
Capital assets at cost, net of accumulated depreciation of \$35 and \$26, respectively	456	2
Total assets	335,818	412,779
LIABILITIES		
Refunds payable and other	14,274	2,363
Mortgage payable	381	-
Total liabilities	14,655	2,363
NET ASSETS		
Invested in capital assets net of related debt	75	2
Held in trust for pension benefits	321,088	410,414
Total net assets	\$ 321,163	\$ 410,416

See accompanying notes to financial statements.

City of Ann Arbor
Employees' Retirement System

STATEMENT OF CHANGES IN PLAN NET ASSETS

Years Ended June 30, 2009 and 2008

(amounts expressed in thousands)

	2009	2008
ADDITIONS TO NET ASSETS		
Investment income (loss)		
Net appreciation (depreciation) in fair value of investments	\$ (93,890)	\$ (30,274)
Interest	5,115	5,699
Dividends	9,300	1,086
Total investment (loss)	(79,475)	(23,489)
Less: investment expense	(1,062)	(1,268)
Net investment (loss)	(80,537)	(24,757)
Contributions		
Employer	14,726	7,517
Plan members	2,815	2,726
Total contributions	17,541	10,243
Total additions to net assets	(62,996)	(14,514)
DEDUCTIONS FROM NET ASSETS		
Benefits	24,984	23,976
Refunds of contributions	633	376
Administrative expense	640	634
Total deductions from net assets	26,257	24,986
CHANGE IN PLAN NET ASSETS	(89,253)	(39,500)
Restated net assets - beginning of year	410,416	449,916
Net assets - end of year	\$ 321,163	\$ 410,416

See accompanying notes to financial statements.

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE A: DESCRIPTION OF SYSTEM AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Ann Arbor Employees' Retirement System (CAAERS) (the System) is a single-employer defined benefit plan established and administered by the City of Ann Arbor to provide retirement, disability and death benefits to general, police and firefighter employees and their beneficiaries. Cost of living adjustments are provided to members and beneficiaries per the Ann Arbor City Code Section 1:573 of Chapter 18. Chapter 17.1 of the Ann Arbor City Charter assigns the authority to establish and amend benefit provisions to City Council.

All plan members are required to contribute 5% of annual compensation. The City is required to contribute at an actuarially determined rate; the current rate is 12.7% of annual covered payroll. Plan provisions and contribution requirements are established and may be amended by the Ann Arbor City Council. Administrative costs of CAAERS are financed through investment earnings.

The System's more significant accounting policies are described below.

Reporting entity. The accompanying financial statements are exclusive presentations of the financial condition and results of operations of the City of Ann Arbor Employees' Retirement System. The City of Ann Arbor is the plan sponsor of CAAERS. As a result, industry standards require the City to include the financial activities of the System in the City's Annual Financial Report. The Annual Financial Report of the City of Ann Arbor is available for public inspection at the Ann Arbor City Hall.

Basis of Accounting. CAAERS' financial statements are prepared using the accrual basis of accounting. Plan member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

Method Used to Value Investments. Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value.

Capital Assets. Capital assets include the building and improvements, and equipment and furniture, and are reported (net of accumulated depreciation) in the Statement of Plan Net Assets. Capital assets are defined by the government as assets with an initial, individual cost of more than \$2,500 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets, if any, is included as part of the capitalized value of the assets constructed. No such interest expense was incurred during the current fiscal year.

Capital assets are depreciated using the straight-line method over the following estimated useful lives:

<u>Type</u>	<u>Years</u>
Building and improvements	40
Equipment and furniture	3 - 15

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE B: PLAN DESCRIPTION AND CONTRIBUTION INFORMATION

Membership of the plan consisted of the following at June 30, 2009 and 2008, according to actuarial valuations as of those dates:

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Retirees and beneficiaries receiving benefits	834	820
Terminated plan members entitled to, but not yet receiving, benefits	126	123
Active plan members	<u>786</u>	<u>805</u>
Total	<u><u>1,746</u></u>	<u><u>1,748</u></u>
Number of participating employers	1	1

NOTE C: DEPOSITS AND INVESTMENTS

Deposits

The System does not maintain any checking or other demand/time deposit accounts. Amounts reported as cash and cash equivalents in the statement of plan net assets are composed entirely of short-term investments in money market accounts.

Investments

The Michigan Public Employees Retirement Systems' Investment Act, Public Act 314 of 1965, as amended, authorizes the System to invest in stocks, government and corporate securities, mortgages, real estate, and various other investment instruments, subject to certain limitations. The System's Board has the responsibility and authority to oversee the investment portfolio. Various professional investment managers are contracted to assist in managing the System's assets. All investment decisions are subject to Michigan law and the investment policy established by the Board.

The System has investments, which are held by an independent trust company. Following is a summary of the System's investments as of June 30, 2009 and 2008:

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Short-term investments	\$ 13,436,860	\$ 6,742,904
U.S. government obligations	25,397,652	41,745,855
Municipal bonds	-	670,129
Collateralized mortgage obligations	1,706,606	-
Guaranteed investment contracts	13,839,244	13,448,605
Domestic and foreign corporate bonds	41,843,407	36,800,303
Domestic and foreign stocks	195,365,581	264,890,660
Real estate - direct and funds	<u>27,245,049</u>	<u>45,989,189</u>
Total investments	<u><u>\$ 318,834,399</u></u>	<u><u>\$ 410,287,645</u></u>

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED

Custodial Credit Risk

For investments, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The System's investment policy requires that investment securities be held in trust by a third-party institution in the System's name. As such, although uninsured and unregistered, the System's investments are not exposed to custodial credit risk since the securities are held by the counterparty's trust department in the System's name. Short-term investments in money market funds are not subject to custodial credit risk.

Credit Risk

The System's investment policy provides that its investments in fixed income securities be limited to those rated investment grade by a nationally recognized statistical rating organization. As of June 30, 2009 and 2008, the System's investments in securities of U.S. agencies were all rated AAA by Standard & Poor's. The System's investments in corporate securities were rated by Standard & Poor's as follows:

<u>Pension Investments</u>	<u>June 30, 2009</u>	<u>June 30, 2008</u>
AAA	\$ 885,718	\$ 1,291,443
AA	1,709,181	4,207,976
A	18,948,016	15,126,027
BBB	10,548,429	6,391,073
BB	2,664,383	3,169,787
B	2,065,925	2,041,041
D	-	10,000
Not rated	<u>5,021,755</u>	<u>4,562,956</u>
	<u>\$ 41,843,407</u>	<u>\$ 36,800,303</u>

Concentration of Credit Risk

The System's investment policy requires that the securities of any one company or government agency should not exceed 5% of the total fund. At June 30, 2009 and 2008, the System's investments were within that range.

Interest Rate Risk

For investments, the risk that changes in interest rates will adversely affect the fair value of the investment is known as interest rate risk. The System's investment policy provides for securities with terms to maturity of up to 30 years. As of June 30, 2009, maturities of the System's debt securities were as follows:

	<u>Fair Value</u>	<u>Weighted Average Maturity (in years)</u>
U.S. treasuries	\$ 8,516,854	5.96
U.S. agencies	16,332,002	13.91
Corporate bonds	37,134,852	6.31
Domestic corporate securities	<u>1,706,606</u>	37.62
Total debt securities	<u>\$ 63,690,314</u>	
Portfolio weighted average maturity		10.62

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE C: DEPOSITS AND INVESTMENTS - CONTINUED

Interest Rate Risk - continued

As of June 30, 2008, maturities of the System's debt securities were as follows:

	<u>Fair Value</u>	<u>Weighted Average Maturity (in years)</u>
U.S. treasuries	\$ 13,009,796	1.30
U.S. agencies	28,736,059	8.32
Municipal bonds	670,129	0.02
Corporate bonds	35,405,992	2.84
Domestic corporate securities	<u>1,394,311</u>	0.49
Total debt securities	<u>\$ 79,216,287</u>	
Portfolio weighted average maturity		12.97

NOTE D: ADMINISTRATIVE AND INVESTMENT EXPENSES

The following provides additional details related to administrative and investment expenses for the year ended June 30, 2009.

<u>Administrative expenses</u>	<u>June 30, 2009</u>	<u>June 30, 2008</u>
Salary	\$ 258,993	\$ 245,329
Office rent	14,351	56,791
Actuary	57,439	24,988
Attorney	51,744	41,587
Information technology services	24,283	52,704
Conferences and training	41,343	44,289
Other	<u>192,320</u>	<u>154,052</u>
	<u>\$ 640,473</u>	<u>\$ 619,650</u>
 <u>Investment expenses</u>		
Bradford & Marzec, Inc	\$ 115,055	\$ 177,369
Northern Trust Co.	114,132	143,931
Independence	112,179	77,763
Loomis, Sayles & Co., Inc.	100,081	71,132
Schwartz	53,904	87,196
Fisher Investments	102,859	223,556
Other investment managers	<u>462,703</u>	<u>486,732</u>
	<u>\$ 1,060,913</u>	<u>\$ 1,267,679</u>

City of Ann Arbor
Employees' Retirement System

NOTES TO FINANCIAL STATEMENTS

June 30, 2009 and 2008

NOTE E: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2009, was as follows:

	<u>Balance July 1, 2008</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance June 30, 2009</u>
Capital assets being depreciated				
Building and improvements	\$ -	\$ 463,416	\$ -	\$ 463,416
Equipment and furniture	<u>28,397</u>	<u>-</u>	<u>-</u>	<u>28,397</u>
Totals at historical cost	28,397	463,416	-0-	491,813
Less accumulated depreciation for:				
Building and improvements	-	(8,499)	-	(8,499)
Equipment and furniture	<u>(26,199)</u>	<u>(657)</u>	<u>-</u>	<u>(26,776)</u>
Total accumulated depreciation	<u>(26,199)</u>	<u>(9,156)</u>	<u>-0-</u>	<u>(35,275)</u>
Capital assets, net	<u>\$ 2,198</u>	<u>\$ 454,260</u>	<u>\$ -0-</u>	<u>\$ 456,458</u>

NOTE F: LONG-TERM DEBT

The following is a summary of changes in long-term debt obligations of the System for the year ended June 30, 2009.

	<u>Balance July 1, 2008</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2009</u>	<u>Due Within One Year</u>
Mortgage payable	\$ -	\$ 400,000	\$(19,246)	\$ 380,754	\$ 20,112

Significant details regarding outstanding long term debt are presented below:

\$400,000 Mortgage payable dated September 1, 2008, due in biannual installments of \$18,417 through March 1, 2023, with interest of 4.45 percent. \$ 380,754

The annual requirement to pay the debt principal and interest outstanding for the bonds is as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2010	\$ 20,112	\$ 16,722	\$ 36,834
2011	21,017	15,817	36,834
2012	21,963	14,871	36,834
2013	22,951	13,883	36,834
2014	23,984	12,850	36,834
2015-2019	137,110	47,062	184,172
2020-2023	<u>133,617</u>	<u>13,724</u>	<u>147,337</u>
	<u>\$ 380,754</u>	<u>\$ 134,929</u>	<u>\$ 515,683</u>

NOTE G: RESTATEMENT OF NET ASSETS

Beginning net assets were restated by \$13,269 to correct an error from the prior year. Certain prior year amounts have been updated to reflect this change.

REQUIRED SUPPLEMENTARY INFORMATION

City of Ann Arbor
Employees' Retirement System

SCHEDULE OF FUNDING PROGRESS

(amounts expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
6/30/2009	\$ 426,283	\$ 455,219	\$ 28,937	93.6 %	\$ 51,076	56.7 %
6/30/2008	428,689	430,438	1,749	99.6 %	51,287	3.4 %
6/30/2007	413,712	413,490	(222)	100.1 %	50,678	-0.4 %
6/30/2006	398,258	407,302	9,044	97.8 %	49,627	18.2 %
6/30/2005	398,690	384,369	(14,321)	103.7 %	47,225	-30.3 %
6/30/2004	409,324	370,409	(38,915)	110.5 %	47,109	-82.6 %

City of Ann Arbor
Employees' Retirement System

SCHEDULE OF EMPLOYER CONTRIBUTIONS

(amounts expressed in thousands)

<u>Year Ended June 30,</u>	<u>Annual Required Contribution</u>	<u>Percentage Contribution</u>
2009	\$ 6,895	214.0%
2008	7,517	100.0%
2007	5,039	100.0%
2006	2,871	100.0%
2005	1,045	100.0%
2004	-	100.0%

City of Ann Arbor
Employees' Retirement System

NOTE TO THE SCHEDULE OF FUNDING PROGRESS
AND SCHEDULE OF EMPLOYER CONTRIBUTIONS

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

Actuarial valuation:	
Frequency	Annual
Latest date	June 30, 2009
Basis for contribution	June 30, 2007
Actuarial cost method	Entry age
Amortization method	Level percent - over 15 year period
Remaining amortization period	15 years
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return*	7%
Projected salary increases	0.4% - 6.0%
*Includes inflation at:	3.5%
Cost-of living adjustments	Determined annually