

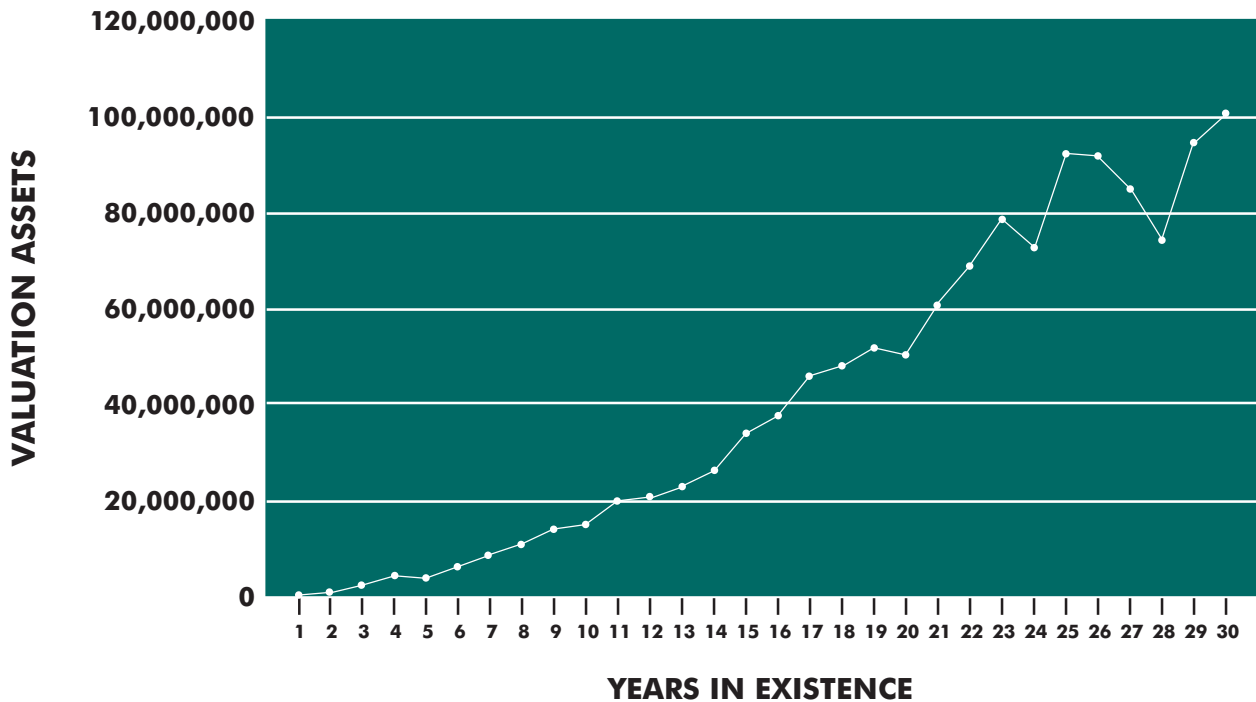
CITY OF MANCHESTER EMPLOYEES' CONTRIBUTORY RETIREMENT SYSTEM



MECRS 30 YEARS OF SERVICE

— *Our Pearl Anniversary* —

Asset Growth 1974 - 2004




COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR PERIOD ENDING DECEMBER 31, 2004



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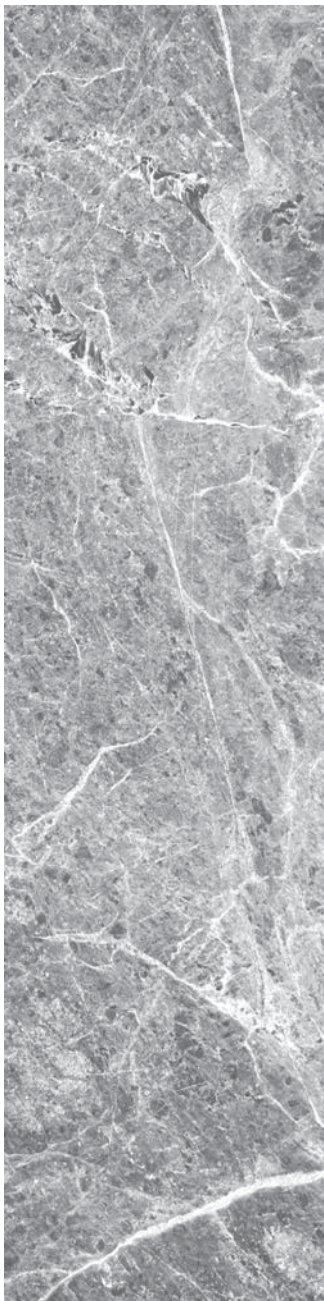
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CITY OF
MANCHESTER
EMPLOYEES'
CONTRIBUTORY
RETIREMENT
SYSTEM



1045 ELM STREET • SUITE 403
MANCHESTER, NH 03101-1824
PHONE (603) 624-6506
FAX (603) 624-6342



As Chairman of the Board of Trustees, I am pleased to present the 2004 Annual Report for the City of Manchester Employees' Contributory Retirement System. This report includes the Financial and Actuarial Valuation summaries of the System's Investment and membership activities for plan year 2004. The report also includes management discussion and analysis of the events of the past year. The results provided demonstrate the Board of Trustees' continuous mission to provide a measure of financial security for the members and beneficiaries of the Retirement System.

As a matter of policy, the Board of Trustees closely monitors the System's asset allocation and investment policies and directs Board activity at maintaining the best mix of investment vehicles to achieve maximum investment return with minimum risk exposure. In order to achieve these results, the investments include domestic and international equities, fixed income securities, real estate, and alternative investments. Investment professionals representing seventeen management firms are hired to actively manage the System's diversified investment portfolio. The soundness of the System's investment and management decisions is intended to ensure future financial security for plan participants.

The Board of Trustees holds asset managers to a strict performance standard. For each manager, performance comparisons are made against a relevant benchmark and peer universe as specified in the System's Investment Manager Objectives. When results fall below both the benchmark and universe median in any one calendar year, the manager will be critically reviewed. A formal watch will be initiated if manager results fall below the performance criteria over any given period. A manager will be placed on probation if this performance is below both the benchmark and universe median, and, once the probationary period begins, the manager will be given four quarters to improve relative performance. If relative performance deteriorates or does not improve, the manager will be subject to termination. The magnitude of performance shortfall, longer-term results and current market conditions will be considered in assessing manager performance. The Board of Trustees also reserves the right to terminate any manager at its discretion.

This Annual Report and in particular the Management Discussion and Analysis section review the results of the System's asset management and administrative operations for Plan Year 2004. The System's investment returns showed positive results once again in 2004 after a very good year in 2003. This was in keeping with the experience of Public Pension Plans nationally for the past year.

On behalf of the Retirement System Board of Trustees and staff, I wish to thank the membership for its support and interest in the Board's activities. The Board is totally committed to improving membership service and communications. I also wish to thank my colleagues of the Board of Trustees and System staff for their continuing effort and dedication throughout the year.

Sincerely,

Arthur J. Beaudry
Chairman, Board of Trustees
City of Manchester Employees' Contributory Retirement System

Board of Trustees



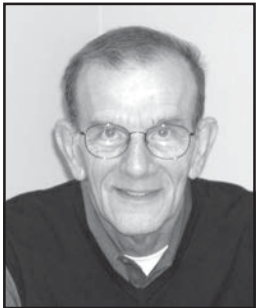
ARTHUR J. BEAUDRY
Chairman
Aldermanic Appointment
Term expires January 1, 2006



KEVIN A. CLOUGHERTY
Treasurer
City Director of Finance
Ex-Officio Member



MAYOR ROBERT BAINES
Ex-Officio Member



CHARLES HUNGLER
Mayoral Appointment
Term expires January 1, 2005



KEVIN G. BARRY
Citizen Representative
Term expires January 1, 2007



DONALD R. PINARD
Employee Representative
Term expires January 1, 2006



MICHAEL D. ROCHE
Employee Representative
Term expires January 1, 2005

Administrative Staff



GERARD E. FLEURY
Executive Director



SANDI ABOSHAR
Executive Assistant

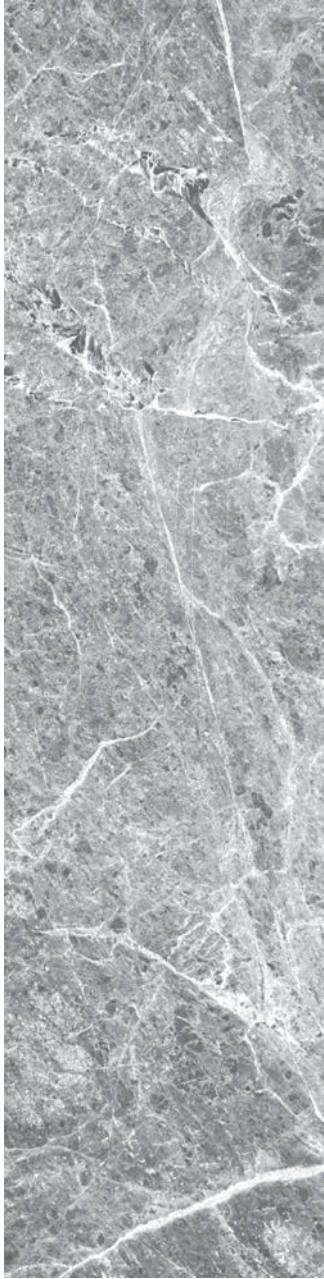


SUZANNE WILSON
Administrative Assistant

CITY OF
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EMPLOYEES'
CONTRIBUTORY
RETIREMENT
SYSTEM



1045 ELM STREET • SUITE 403
MANCHESTER, NH 03101-1824
PHONE (603) 624-6506
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Dear Plan Participant:

I am pleased to present this Annual Report of the City of Manchester Employees' Contributory Retirement System (MECRS) for the fiscal year ended December 31, 2004. This report is submitted in compliance with Chapter 218:6, II, Laws of 1973, as amended, and is intended to satisfy public pension plan financial reporting requirements and to give City employee members confidence that the Board of Trustees is responsibly managing fund assets. The MECRS Annual Report was prepared to conform to the most current reporting Governmental Accounting Standards Board pronouncements.

The MECRS created as a tax-qualified governmental retirement plan under sections 401(a) and 414(d) of the United States Internal Revenue Code, as amended, was established under the provisions of New Hampshire Chapter 218, Laws of 1973 and became effective on January 1, 1974. Its purpose is to provide service and disability retirement benefits to those City employees who are not Police Officers, Firefighters, or Teachers and who are not eligible to participate in the New Hampshire Retirement System.

The MECRS is administered by a seven-member Board of Trustees whose responsibilities include the formulation of policy and determination of employee eligibility for participation and benefits. The Board also oversees the daily administrative, fiscal and asset investment operations of the System.

As part of the Board's ongoing efforts at keeping System operations up-to-date and efficient, a new website was placed in operation in 2004. The website allows members to obtain a personal identification number, (PIN) and to then access and confirm information about their account. Even without a PIN, members and interested parties can access generic information relative to the Plan and check on late breaking developments updated weekly in the News section.

This year also saw the passage of a benefit improvement for participants who are still active and who were members between 1974 and 1999. Chapter 159 Law of 2004 enacted by the New Hampshire Legislature was ratified by voters of the City in September of 2004 and becomes effective on July 1, 2005. Further details on that legislation are contained within this report.

In closing, on behalf of the Board of Trustees, I want to reiterate our commitment to prudent asset management and thoughtful plan design which should in turn contribute to the stability of your Retirement Plan.

Gerard E. Fleury
Executive Director

Portfolio Managers, Advisors, and Service Providers

AS OF DECEMBER 31, 2004

INVESTMENT ADVISOR

Prime Buchholz & Associates, Inc.

ACTUARIAL CONSULTANT

Gabriel, Roeder, Smith & Company

CUSTODIAN

State Street Bank & Trust Co.

INDEPENDENT AUDITOR

Berry, Dunn, McNeil & Parker

LEGAL ADVISOR

McLane, Graf, Raulerson & Middleton

DOMESTIC EQUITY

Boston Company Mid Cap Value
(Separate Account)

Cadence Large Cap Growth
(Separate Account)

State Street Global Large Cap Value
(Group Trust)

Turner Mid Cap Growth
(Group Trust)

INTERNATIONAL EQUITY

Causeway International
(Group Trust)

Gryphon International
(Group Trust)

EMERGING MARKETS EQUITY

City of London
(Group Trust)

Eaton Vance (a/k/a Pimco)
(Group Trust)

ALTERNATIVE EQUITY

Bank Boston Private Equity Portfolio
(Group Trust)

Boston Millennia
(Group Trust)

FIXED INCOME

Income Research and Management
(Separate Account)

Loomis Sayles
(Group Trust)

REAL ESTATE

Cigna
(Group Trust)

Morgan Stanley
(Group Trust)

PRISA
(Group Trust)

TIMBERFUNDS

RMK Timberland Group
(Group Trust)

TACTICAL ASSET ALLOCATION

Mellon Domestic and Global Funds
(Separate Account)

Investment Manager Objectives for Active Managers

— EQUITY —

DOMESTIC VALUE

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of value style equity investment managers.

Objective #2 - Exceed the S&P 500 Index by 100 basis points annually, over a three year period. Over interim periods the R1000 Value is the performance benchmark. Relative strength expected in falling markets.

DOMESTIC MIDCAP VALUE

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of midcap value style equity investment managers.

Objective #2 - Exceed the Russell Midcap Value Index by 100 basis points annually, over a three year rolling period. Relative strength expected in rising markets.

DOMESTIC GROWTH

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of growth style equity investment managers.

Objective #2 - Exceed the S&P 500 Index by 100 basis points annually, over a three year rolling period. Over interim periods the R1000 Growth is the performance benchmark. Relative strength expected in rising markets. May invest up to 5% of the portfolio in equity REITs.

DOMESTIC MIDCAP GROWTH

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of midcap growth style equity investment managers.

Objective #2 - Exceed the Russell Midcap Growth Index by 100 basis points annually, over a three year rolling period. Relative strength expected in rising markets.

INTERNATIONAL

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of non-U.S. equity investment managers.

Objective #2 - Exceed the EAFE Index by 100 basis points annually over a three year rolling period. Relative strength expected in falling markets.

EMERGING MARKETS

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of emerging market equity investment managers.

Objective #2 - Exceed the IFC Index by 100 basis points annually over a three year rolling period. Relative strength expected in falling markets.

PRIVATE EQUITY/VENTURE CAPITAL

Objective #1 - Perform above the U.S. public markets net of all fees and expenses over the life of the partnership through investments in privately held companies primarily in healthcare and life sciences, telecommunications and information technology industries.

Objective #2 - Exceed the average return produced by venture capital and private equity funds of similar vintage over the life of the partnership.

DIVERSIFIED

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of fixed income investment managers.

Objective #2 - Exceed the Lehman Aggregate Index by 100 basis points annually over a three year rolling period.

INTERMEDIATE

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of intermediate fixed income investment managers.

Objective #2 - Exceed the Lehman Government/Corporate Intermediate Index by 50 basis points annually over a three year rolling period.

TIMBERLAND

Objective #1 - Perform above median consistently over a three year rolling period compared to a universe of timber investment managers.

Objective #2 - Exceed a real return of 8% per annum.

Summary Plan Description

This document has been prepared in compliance with Chapter 218:6, II, Laws of 1974 as amended and is intended to provide the reader, especially new entrants to the plan, with a summary of important plan provisions. Information contained in this summary plan description is only intended to provide the membership of the MECRS and other interested parties with a general overview of the plan. While every effort is, and will be made to keep information in this description as accurate and up-to-date as possible, no retirement or financial decisions should be made based solely on information contained herein. Questions on matters of entitlement or process should be addressed in writing to the system's administrative office at the address shown below.

Type of Plan: The Manchester Employees' Contributory Retirement System is a "defined benefit" plan and operates pursuant to Section 8.09 of the City Charter of Manchester, New Hampshire, in accordance with the State of New Hampshire Laws of 1973, Chapter 218 as amended, and is intended to create a tax-qualified governmental retirement plan under sections 401(a) and 414(d) of the Internal Revenue Code as amended. This defined benefit plan is superior to defined contribution plans in that it calculates the retirement benefit based upon average final earnings, creditable service, and age at retirement as opposed to simply the total accumulation of dollars in the plan. The System is governed by a seven member board in accordance with Articles I and II of its By Laws and operates in accordance with Administrative Rules established for that purpose. Relevant financial and demographic information about the System is contained in this report and on a website maintained by the System at www.ManchesterRetirement.org. That information is also available in hard copy upon request from the System's administrative offices. The System exists for the benefit of its membership and maintains administrative offices in Suite 403 of the Chase Building at 1045 Elm Street in Manchester, New Hampshire.

The system may be contacted through its Executive Director by any of the methods listed below:

By phone at: 603-624-6506

By fax at: 603-624-6342

By email at: Gfleury@ManchesterRetirement.org

Or by writing to: Manchester Employees Contributory Retirement System
1045 Elm Street, Suite 403, Manchester, NH 03101-1824

Membership

The Retirement System applies to all full-time and permanent employees of the City, including elected and appointed officials. The Retirement System does not cover certain categories of employees, such as temporary employees, members of boards and commissions who are not full-time or permanent part-time employees of the City, members of the fire and police departments who are eligible to participate in a state-administered retirement system, and other persons who are, or were, eligible to participate in the New Hampshire Retirement System.

All covered employees hired after January 1, 1974 are required to participate in the Retirement System as a condition of employment. Employees are 100% vested after five years of service. The normal retirement age is 60 and the benefit is calculated at 1.5% of final average total compensation during the highest three years or 36 highest consecutive months of service in the last ten years of service (hereafter final average earnings) multiplied by the years of service. The benefit was increased to 2% for service completed after January 1, 1999. Effective July 1, 2005, members who are still in service and have time from prior to January 1, 1999 will be afforded an option to upgrade that service multiplier to 2% pursuant to established laws and supporting rules established by the Board. Permanent employees of the City of Manchester prior to January 1, 1974 who were in service as of January 1, 1974, are eligible for early retirement if credited with no less than twenty (20) years of service.

Duties of the Board of Trustees

The retirement board is the trustee of the retirement fund and has the obligation of a fiduciary to the retirement system and its members and beneficiaries. In the fulfillment of its duties and responsibilities, the retirement board acts solely in the interests of the Retirement System, the members, and the beneficiaries and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. As trustee, the retirement board holds legal title to all securities and assets of the Retirement System and has full control and management of them with the power to invest and reinvest the same in accordance with the terms, conditions, limitations, and restrictions imposed by the general statutes of the state of New Hampshire governing the investment of trust funds. In addition to those powers, the retirement board, as trustee, also has the power to: collect and receive any and all monies and other property due and to give full discharge and acquaintance therefore; appoint advisory committees to aid the retirement board in its duties under this section or to delegate to any corporate fiduciary or an insurance company within or without the state who may or may not be the custodian of stocks and securities, the power and discretion to make decisions with regard to the purchase or sale of any legal object of investment and to take any action necessary to affect decisions by or on behalf of the Retirement System with the same legal effect as if performed by the retirement board; authorize the payment of compensation to an agent for retirement fund management services; settle or compromise any claims, debts or damages due or owing to or from the Retirement System, and to commence or defend suits or legal proceedings whenever, in its judgment, any interest of the Retirement System so requires employing suitable agents and counsel for this purpose and paying their reasonable expenses and compensation; maintain records of receipts and disbursements and to pay benefits required under the Retirement System to eligible members, or, in the event of their death, to their beneficiaries; and generally do all other things necessary and proper to carry out the operation of the Retirement Fund.

Contributions

Contributions to the plan consist of a member component which equates to 3.75% of wages as defined by regulation, and an employer component which varies from year to year with the outcome of an annual actuarial valuation. The factors which can influence the employer's cost of participation include many variables which are cited in the valuation report and can be obtained upon request. Member contributions are deducted by the employer and remitted to the System following each payroll cycle. The City's matching contribution may be paid in a lump sum at the beginning or end of a plan year, or spread into quarterly payments in keeping with payment schedules prepared and provided by the actuary.

Additional Contributions

Additional Contributions, which went into effect July 1, 2004, provide an option for members to *either* reduce the offset associated with retiring prior to age 60 or, for the member who upon reaching the normal retirement age, lacks the service required to attain a 50% retirement benefit. The amount needed to *either* reduce the early retirement offset or provide a 50% benefit, is derived from the member making additional after tax contributions to their account. Determining how much a member is obligated to pay if they decide to pursue this option and simultaneously determining the contribution limit dictated by Federal regulations on such payments is done by means of an actuarial calculation which must be done at the member's expense. Member's who are rapidly approaching their anticipated date of retirement and who are otherwise in a position to avail themselves of this benefit option are advised to contract the System for further details.

Tax Shelter Plan

Member contributions deducted from salary by the employer, remitted to the plan on the employee's behalf, and indexed at the prescribed rate of 3.75% are considered tax sheltered under sections 401(a) and 414(h) of the Internal Revenue Code as amended. This pre-tax status is only extended to contributions which are a percentage of wages earned for the period. Other amounts paid in by the member on a voluntary basis for purposes such as Additional Contributions or for any other form of permissive service purchase are considered to have been made with post tax dollars. Those post tax contributions are tracked by the system and will be reported as tax exempt in accordance with applicable Federal Tax Rules at the time of their eventual distribution.

Creditable Service

Creditable Service refers to the amount of time a plan participant spends in the service of the employer. Service rendered for the full normal working time in a period of 12 consecutive months entitles a member to one year of service credit. Time spent as a member of any of the various city boards, or in any other capacity rendering incidental employment to the city, is not counted as service. Absence from employment on account of active duty with the armed forces of the United States in time of emergency or war, or as directed by selective service or to meet selective service requirements, or as a member of the national guard, or organized reserves, to meet its requirements, is counted as continuous employment with the city, provided, that the employee returns directly to active employment with the city within 90 days after he or she becomes eligible for release from such active duty. Any such period of absence is not counted as service unless the employee completes a service buyback.

Normal Service Retirement

Any member who either has attained the age of 60 years or was in the service of the city on January 1, 1974 and has completed at least 20 years of service, is eligible for a normal service retirement benefit. Any such member may retire by filing with the retirement board, a written statement duly attested setting forth the time subsequent to the date of filing that the member desires to be retired, or the retirement board may, at its option, retire any such eligible member, furnishing written notice thereof at least 60 calendar days in advance of the specified date of such retirement.

The payment of retirement benefits to any member who is eligible to receive them and who has filed all election forms with the Retirement System shall become effective the first day of the month following termination of employment pending approval by the retirement board. No changes to benefit elections are permitted after the commencement of the payment of benefits.

The Retirement System shall not pay retirement or disability benefits to city employees who again become eligible to participate in the Retirement System. A member shall notify the Retirement System of their rehire immediately. Upon rehire after a period of termination, all disbursements under the Plan to that member shall cease and the member must resume making contributions to the retirement fund as of the first pay period following their rehire. Rehired members shall have their benefits determined in accordance with laws governing "restoration to service as define in the system's enabling legislation.

Notwithstanding any other provisions, the maximum pension payment payable to any member or beneficiary shall be limited to such extent as may be necessary to comply with the requirements of sections 401(a)(16), 401(a)(17) and 415 of the Internal Revenue Code. The retirement benefits payable hereunder shall be made in the form, at such time and otherwise in compliance with the distribution and rollover requirements of sections 402(c), 401(a)(9), and 401(a)(31) of the Code.

Members who qualify for a normal service retirement benefit shall receive an annual pension payable during the member's lifetime in an amount equal to the sum of: one and 1/2 percent of the member's final average earnings multiplied by the number of years, including the fractions of years represented by full months, of service completed prior to January 1, 1999; plus two percent of the member's final average earnings multiplied by the number of years, including the fractions of years represented by full months, of service completed after December 31, 1998. However, in the case of a member who both was in the employ of the city on January 1, 1974 and has completed not less than 20 years of service at the time of retirement, the annual pension payable during the member's lifetime shall be equal to the greater of the sum of the amounts determined in accordance with methods stated in the paragraph above, or 50 percent of final average earnings.

Early Retirement

Each member whose age plus years of service equals 80, or who attains age 55 with a minimum of 20 years of service, may have the option, to be exercised by a written notice to the retirement board, to retire at any time thereafter, prior to the member's normal retirement date. The amount of retirement benefits payable to such retired member shall be computed as provided in accordance with prevailing laws and regulations, except that the date of such early retirement shall be used in determining the member's service, and the amount thus obtained will be reduced for each month by which the date on which benefits commence precedes the month after which the member attains 60 years of age by 1/6 of one percent.

The contingent annuitant and 10-year certain options provided for in Plan Law may be elected by a member under this section, in which case the term "retirement date" shall be deemed to mean early retirement date wherever applicable with respect to laws dealing with Member Death Benefits by reasons of accidental or ordinary death.

Vesting

Vesting is the process through which a plan participant becomes irrevocably entitled to a monthly pension benefit in lieu of a cash distribution of paid in contributions and interest. A vested member is almost always financially better off collecting a monthly annuity from a defined benefit plan such as this one as opposed to collecting the cash payout. For the MECRS, vesting is achieved after the completion of five (5) years of participation and contribution into the plan.

Ordinary Disability Retirement

Any member of the retirement system who, after 15 years of continuous service as an employee of the city, becomes totally and permanently disabled such that they are incapable of performing the essential functions of their position prior to such disability, may be retired for disability according to the prevailing regulations. The determination as to total and permanent disability shall be made by the retirement board upon review of an application for disability benefits submitted by the member and consultation with at least 2 impartial physicians selected by the retirement board who shall examine the member and submit written reports to the retirement board.

Members who retire for disability of this type shall be entitled to an annual disability benefit payable until the earlier of the termination of such disability or their death, computed on the basis of service completed prior to the date of disability in an amount equal to the sum of: One and 1/2 percent of the member's final average earnings multiplied by the number of years, including the fractions of years represented by full months, of service completed prior to January 1, 1999; plus two percent of the member's final average earnings multiplied by the number of years, including the fractions of years represented by full months, of service completed after December 31, 1998. Disabled members may also receive their disability benefit in the form of a contingent annuity as described under "Optional Retirement Allowances" later in their document.

Accidental Disability Retirement

Any member of the retirement system who becomes totally and permanently disabled such that they are incapable of performing the essential functions of their position prior to such disability, if such total disability is shown, to the satisfaction of the retirement board, to have been sustained during the performance of duties pertaining to the member's employment by the city, shall be entitled to retirement for disability irrespective of the duration of employment. In order for a member to receive such disability benefits, the member must submit an application for disability benefits within 60 days of termination of employment. However, any member receiving a disability benefit on account of total and permanent disability sustained during the performance of duties pertaining to employment by the city, as provided herein, shall receive a benefit equal to the greater of the sum of the amounts determined in accordance with the formula for Ordinary Disability in the section above, or 50 percent of final average earnings. If a member has less than 3 years of service at the time of becoming totally disabled in the performance of duties pertaining to their employment by the city, their pension shall be based upon their annualized disability earnings. The disabled member may also receive their disability benefit in the form of a contingent annuity as described further on in this document.

Ordinary Death Benefit

An ordinary death benefit may be payable upon receipt by the board of trustees of proper proof of the death of a member in service indicating that such death was not the result of an accident occurring while in the performance of duty. In such cases, there shall be a death benefit payable to the member's surviving spouse or designated beneficiary or beneficiaries, if living, or otherwise to the member's estate.

If the member had at least 5 years creditable service or was eligible for service retirement at the time of their death and had not designated a beneficiary or beneficiaries other than the a spouse, there shall be payable to the member's surviving spouse, continuing until the spouse's death or remarriage, the greater of either an allowance equal to 50 percent of the service retirement allowance that would have been payable to the member had the member retired immediately prior to death, based on final average earnings and creditable service at the time of death, or an allowance computed according to the member's length of service and the reduction in benefit payments computed for a 100 percent contingent annuitant option and for early retirement.

In lieu of an allowance, the surviving spouse may elect a lump sum benefit equal to the deceased member's annual earnings at the time of death, in addition to a refund of contributions.

If the member did not have at least 5 years of creditable service and was not eligible for service retirement at the time of death, there shall be payable to the member's spouse or the member's designated beneficiary or beneficiaries, if other than the member's spouse, if living, or otherwise to the member's estate, a lump sum benefit equal to the deceased member's annual earnings at the time of death in addition to a refund of contributions.

However, if the member had at least 5 years creditable service or was eligible for service retirement, but is not survived by a spouse, or has designated a beneficiary or beneficiaries other than their spouse, there shall be payable to the person or persons nominated by the member, if living, or otherwise to the member's estate, a lump sum benefit equal to the deceased member's annual earnings at the time of death, in addition to a refund of contributions.

Accidental Death Benefit

An accidental death benefit may be payable upon receipt by the board of trustees of proper proof of the death of a member in service indicating that such death was not the result of an accident occurring while in the performance of duty. There may also be a death benefit payable to the member's surviving spouse or designated beneficiary or beneficiaries, if living, or otherwise to the member's estate.

If the member has at least 5 years creditable service or was eligible for service retirement at the time of their death and had not designated a beneficiary or beneficiaries other than their spouse, then a benefit shall be payable to the member's surviving spouse, continuing until the spouse's death or remarriage. That benefit shall be the greater of either an allowance equal to 50 percent of the service retirement allowance that would have been payable to the member had the member retired immediately prior to death, based on final average earnings and creditable service at the time of death, or an allowance computed according to the member's length of service and the reduction in benefit payments computed for a 100 percent contingent annuitant option and for early retirement. In lieu of an allowance, the surviving spouse may elect a lump sum benefit equal to the deceased member's annual earnings at the time of death, in addition to a refund of contributions.

If the member did not have at least 5 years creditable service and was not eligible for service retirement at the time of death, then a benefit shall be payable to the member's spouse or the member's designated beneficiary or beneficiaries, if other than the member's spouse, if living, or otherwise to the member's estate, a lump sum benefit equal to the deceased member's annual earnings at the time of death in addition to a refund of contributions.

However, if the member had at least 5 years creditable service or was eligible for service retirement, but is not survived by a spouse, or has designated a beneficiary or beneficiaries other than their spouse, there shall be payable to the person or persons nominated by the member, if living, or otherwise to the member's estate, a lump sum benefit equal to the deceased member's annual earnings at the time of death, in addition to a refund of contributions.

Optional Retirement Allowances

— CONTINGENT ANNUITANT OPTION —

Instead of the normal form of monthly retirement benefit provided by a Service Retirement, a member may, prior to his or her retirement date, elect a contingent annuitant option providing, if the member does not die before his or her retirement date, for actuarially reduced monthly retirement benefits payable during his or her lifetime after retirement and for the continuance of such payments, or a part of them specified by the member, to such contingent annuitant for his or her life after the death of a retired member. Such election may be made by a member at any time prior to his or her retirement date and may not be changed after his or her retirement date. The death of the contingent annuitant at any time prior to the member's retirement date shall automatically revoke such election; and further provided that if the contingent annuitant is the spouse of the member, a divorce granted to either spouse at any time prior to the member's retirement date shall automatically revoke such election.

If a member who has elected this option dies before his or her retirement date, no benefits shall be payable to the contingent annuitant under this option. In such circumstances, benefits, if any, are to be paid in accordance with provisions associated with a Death Benefit or a Termination of employment. If the member dies after his or her retirement date, the contingent annuitant shall receive for life, commencing on the first day of the calendar month coinciding with or next following the retired member's death, the benefits specified by the retired member for the contingent annuitant.

If the contingent annuitant dies before the member's retirement date, the monthly retirement benefit normally provided under this act shall be payable to the retired member as if the option had not been elected. If the contingent annuitant dies after the member's retirement date, the amount of the payments which the retired member is then receiving or is entitled to receive will at that time (with no provisions for retroactive payments) revert back to what it would have been at the member's retirement date if the option had not been elected and will cease upon the retired member's death.

Instead of the normal form of disability benefit, a disabled member may, prior to the start of disability benefits, elect a contingent annuitant option providing for actuarially reduced monthly disability benefits payable during his or her lifetime and for the continuance of such payments, or a part of them as specified by the disabled member, to such contingent annuitant for his or her life after the death of the disabled member.

Once the contingent annuitant option has been elected by a disabled member, it may not be changed or revoked except in the case of death of the contingent annuitant. If the contingent annuitant dies after the disabled member has started receiving disability benefits, the amount of the payments which the disabled member is then receiving or is entitled to receive shall at that time with no provisions for retroactive payments revert back to what it would have been at start of the payment of disability benefits if the option had not been chosen and will cease upon the disabled member's death.

— TEN-YEAR CERTAIN OPTION —

Instead of the normal form of monthly retirement benefit provided by a Service Retirement, a member may elect an actuarially reduced monthly retirement benefit payable for 10 years certain and life thereafter. Such election may be made by a member at any time prior to his or her retirement date and may not be changed after his or her retirement date. Under this option, 120 monthly payments will be made regardless of how long the member lives. If a member dies after his or her retirement date, but before 120 monthly payments have been made, the balance of the 120 monthly payments shall be made to the member's

beneficiary. If the beneficiary, having survived the retired member, dies before all of said 120 payments have been made, then the commuted value of the balance of said payments shall be paid in a lump sum to the beneficiary's estate. If the member dies before his or her retirement date, no benefits shall be payable under this option. If the member survives beyond the 120 month guaranteed payment period, actuarially reduced monthly retirement benefits shall continue until the death of the member at which point the benefit payments shall cease.

Cost of Living Adjustments

The Board of Trustees may adjust the payment to retirees to maintain their incomes at the approximate level with their real incomes at the time of retirement. The Trustees *may* grant a cost of living adjustment (“COLA”) provided that sufficient funds are available to fund any additional benefits either through earnings of the retirement fund or through such special appropriation by the city as may be approved by the board of mayor and aldermen. The determination as to whether sufficient funds are available is determined in accordance with Administrative Rule 7.0 which can be obtained on the System’s website at www.ManchesterRetirement.org or by contacting the System and requesting a copy of the Administrative Rules. The amount of any COLA to be granted is determined by applying a standard measured by the U.S. City Average Consumer Price Index for all items as published by the Bureau of Labor Statistics of the U.S. Department of Labor (“Price Index”).

Refunds of Contributions

Upon termination of employment, a member becomes eligible for a return of contributions deducted and remitted by the employer along with any additional contributions and permissive service purchases paid in, plus all applicable interest. This payment option is available to all members upon termination of employment but should generally be considered only by members who have not attained vested status. Under no circumstances is a terminated member applying for a lump sum distribution eligible to receive a payout of the employer matching portion.

A member who is less than 59 ½ years of age and who does not elect to “roll over” the taxable portion of a distribution from their plan may be subject to mandatory 20% withholding on their distribution and obligated to pay a 10% excise tax on their early distribution. Plan members who must terminate their affiliation with the System and are not eligible to vest can obtain the necessary forms from the Systems administrative staff to perform a roll over and avoid tax consequences of the transaction. The System is not in a position to assist members with tax questions and does not offer investment advice. Members with questions on the disposition of funds received following termination from employment should seek the counsel of tax and financial professionals.

Buybacks & Permissive Service Purchases

A member who ceases to be a member, withdraws their member contributions as described above, and later becomes a member again, may make a request after their return to service for the City for a service buyback of prior service credit for the previous time served as a member. If a service buyback is not made, the member’s benefit shall be based solely on the member’s years of service and final average earnings after the break in service.

A member may also make a service buyback request to receive prior service credit for a period prior to becoming a member during which the member was employed by the city in a temporary position or out on worker’s compensation, leave of absence, or engaged in CETA, model city program, or any other capacity the retirement board determines warrants a service buyback. A service buyback for temporary service may only be made if the member became a permanent city employee without incurring a break in service. A service buyback is also available if an employee elected not to participate in the retirement system when hired and otherwise satisfies the requirements of membership cited above.

If a member does not purchase all available prior service credit, the service credit purchase must begin on the latest date of service available. Members are required to submit proof of employment in order to substantiate prior service.

Upon a request for service buyback, the retirement board determines the cost of the requested service buyback, which amount includes the contributions the member would have been required to make plus buyback interest, and provide a written statement to the member. The member must pay all amounts related to the service buyback in one lump sum.

Effective December 12, 1994, contributions, benefits, and service credit with respect to qualified military service shall be provided in accordance with section 414(u) of the Code notwithstanding any provision of this chapter to the contrary.



INDEPENDENT AUDITORS' REPORT

Administrative and Accounting Committee
City of Manchester Employees'
Contributory Retirement Plan

We have audited the accompanying comparative statements of net assets available for benefits of City of Manchester Employees' Contributory Retirement System (the Retirement System) as of December 31, 2004 and 2003, and the related comparative statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Retirement System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Retirement System as of December 31, 2004 and 2003, and the changes in its net assets available for benefits for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 1, 2005 on our consideration of the Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 17 through 22 and the historical pension information on pages 30 through 34 are not a required part of the general-purpose financial statements but are supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Manchester, New Hampshire
April 1, 2005

Management Discussion and Analysis

Our discussion and analysis of the City of Manchester Employees' Contributory Retirement System's (System) financial performance provides an overview of the System's financial activities for the fiscal year ended December 31, 2004. Please read it in conjunction with the transmittal letter from the Chairman of the Board of Trustees and the System's audited financial statements.

FINANCIAL HIGHLIGHTS

- The System's total net assets held in trust for pension benefits were \$106.2 million at December 31, 2004.
- The System's net assets increased by \$10.6 million which is primarily due to gains realized on trades and to dividend income on investments.
- Employer and employee contributions to the plan were \$5.6 million which represents a \$709,076 increase over the preceding year. The employer share of increased contributions represented 83.5% of the total.
- Benefits paid to plan participants were \$5.0 million. At December 31, 2004, there were 519 retirees and beneficiaries in receipt of pension benefits.

Using this Annual Report

This annual report consists of a series of financial statements. The *Comparative Statements of Net Assets Available for Benefits* and *Comparative Statements of Changes in Net Assets Available for Benefits* (on pages 23 and 24) provide information about the activities of the System and the net assets held in trust for pension benefits. The financial statements also contain actuarial information on the value of plan assets, accrued liability and the significant actuarial assumptions used in the actuarial valuations.

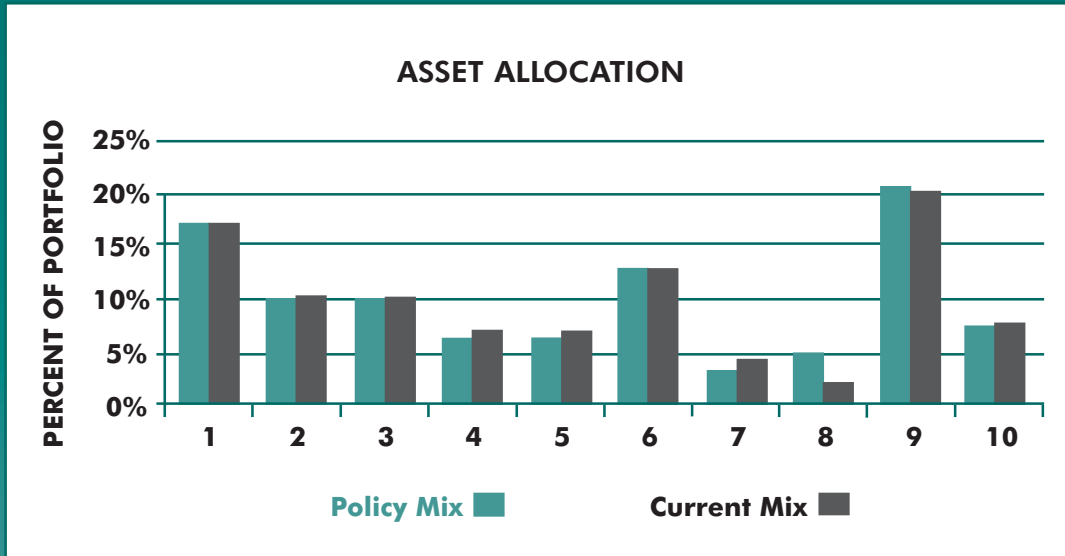
Reporting on the System's Finances as a Whole

One of the most important questions asked about the System's finances is: "Is the System as a whole better or worse off as a result of the year's activities?" The *Comparative Statements of Net Assets Available for Benefits* and the *Comparative Statements of Changes in Net Assets Available for Benefits* report information about the System as a whole and about its activities in a way that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to accounting used by private-sector retirement plans. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the System's net assets and changes in them. You can think of the System's net assets – the difference between assets and liabilities – as one way to measure the System's financial health, or financial position. Over time, increases or decreases in the System's net assets are one indicator of whether its financial health is improving or deteriorating. You will also need to consider the actuarial liability or surplus as determined at the first day of each plan year.

Investment Policy

The Board's investment policy permits fund assets to be invested in U.S. and non-U.S. equities, U.S. and non-U.S. fixed income securities, and equity real estate commingled funds.



ASSET ALLOCATIONS AMONG VARIOUS CLASSES ARE:

	<u>POLICY MIX</u>	<u>CURRENT MIX</u>
1) TAA	17.00%	17.00%
2) LARGE CAP VALUE	10.00%	10.40%
3) LARGE CAP GROWTH	10.00%	10.30%
4) MID CAP VALUE	6.30%	7.20%
5) MID CAP GROWTH	6.30%	7.10%
6) INTERNATIONAL EQUITY	12.90%	12.90%
7) EMERGING MARKETS	3.90%	4.40%
8) ALTERNATIVE EQUITY	5.00%	2.10%
9) DOMESTIC FIXED	21.10%	20.10%
10) CASH/OTHER	7.50%	7.80%

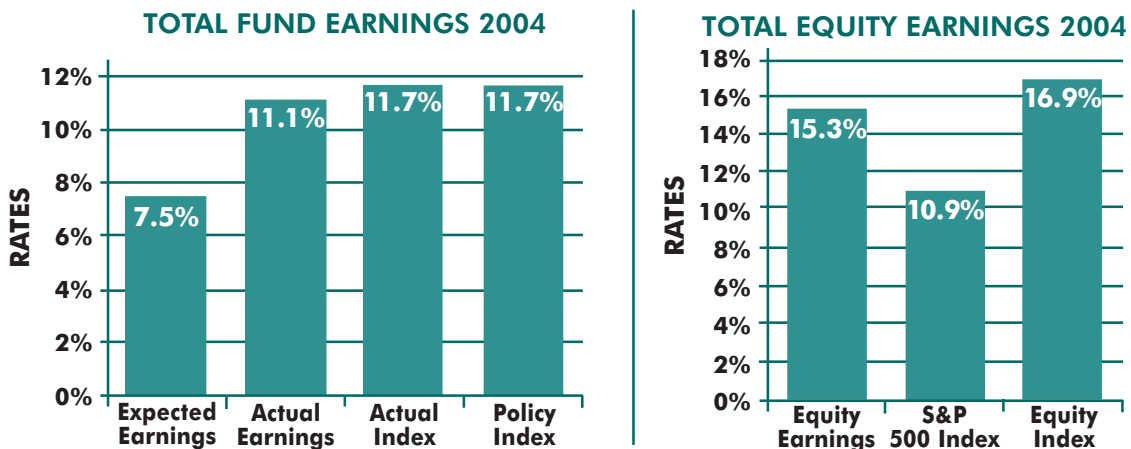
The Board of Trustees' investment objectives and risk tolerance are intended to achieve a maximum total return with emphasis on preservation of capital in real terms. The investment mix is designed to participate in rising markets, with defensive action expected to an even greater degree in declining markets. Total return includes interest, dividends, and realized/unrealized gains or losses from investments.

System's Activities

Operationally, Plan expenses for the period ending December 31, 2004 were \$5.9 million. This total includes \$.7 million in administrative expenses, \$.2 million in refund of employee contributions and \$5.0 million in benefits paid to retired members and beneficiaries. A total of 1,937 City employees were participants or beneficiaries at year-end.

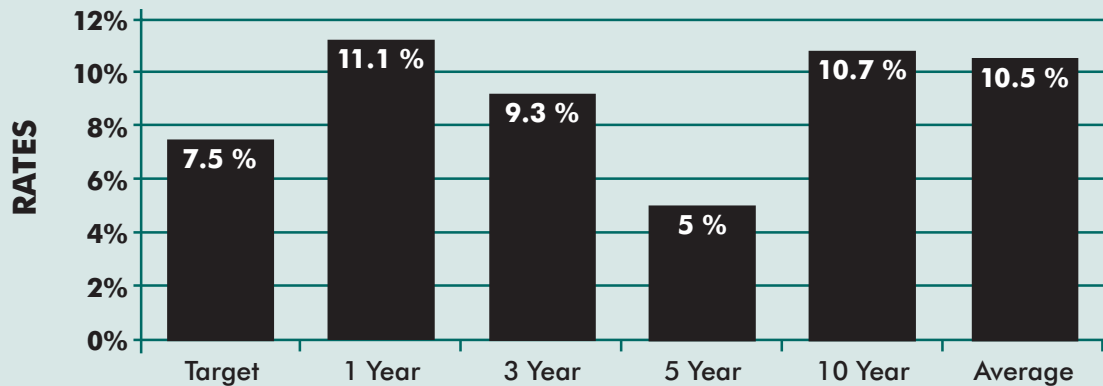
The value of Plan assets, after subtracting liabilities of the Plan, was \$106,244,443 and \$95,632,743 as of December 31, 2004 and December 31, 2003, respectively. For the year 2004, the Plan experienced an increase in its net assets in the amount of \$10,611,700 and an investment rate of return of 11.1%. Total fund earnings had a second consecutive year in positive territory.

To help assess investment performance, various indexes are employed including a Policy Index, an Actual Index, and an Equity Index. The Policy Index is a custom benchmark consisting of indices which are weighted based upon the asset allocation targets within the portfolio and it measures the return of the asset allocation strategy if it were implemented using passive (index) portfolios. The Actual Index is another custom benchmark weighted upon the allocation of each asset class within the overall structure at the beginning of each quarter. It measures the return of the current asset allocation, again as if it were implemented using passive (index) portfolios. Finally, the Equity Index is similar to the Policy Index but only includes the equity segment indexes and serves as a basis for comparison to total equity performance.



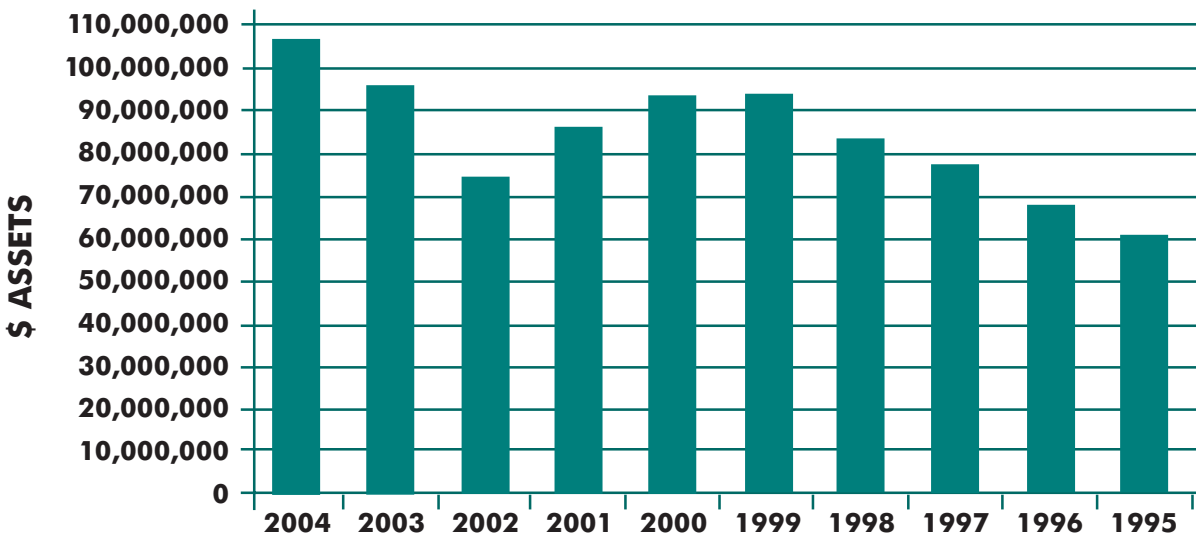
Total Plan Investments ended the year with a gain of 11.1%, slightly out-performing the 10.9% rate of return of the S&P 500 Index. Equities for the fund when measured alone achieved a return of 15.3% again exceeding the S&P 500.

PERIOD RATES OF RETURN THROUGH 2004



For the Plan year ended December 31, 2004, the System's rate of return for one and three year periods exceeded the target rate of 7.5% at 11.1% for the one year and outperformed the target rate for the three year average at 9.3%. The five year rate of return underperformed owing to a few poor years after the turn of the century with a rate of 5.0% but the ten year rate of return outperformed the anticipated rate of 7.5% at 10.7%. The historical rate of return (Since Inception of March 1989 the Plan) exceeded the anticipated return of 7.5% by 3.0%.

TEN YEAR HISTORY OF NET ASSET AVAILABLE FOR BENEFITS VALUES AS OF 12/31/04



The year 2004 saw a second year of positive performance in U.S. equities following last year's double digit increase. The System's total portfolio increased by 11.1% during 2004, ending the year with \$106.2 million in net assets. Historical net asset values for the past ten years are shown here.

<u>YEAR</u>	<u>NET ASSETS</u>	<u>YEAR</u>	<u>NET ASSETS</u>
2004	\$106,244,243	1999	\$93,302,993
2003	\$95,632,743	1998	\$83,450,037
2002	\$74,796,544	1997	\$77,944,473
2001	\$85,786,154	1996	\$68,702,121
2000	\$93,034,852	1995	\$60,600,021

CITY OF MANCHESTER EMPLOYEES' CONTRIBUTORY RETIREMENT SYSTEM

Schedule of Administrative Expenses

	2004	2003	% Increase or Decrease
<u>TRUST RELATED EXPENSES</u>			
Actuarial Expenses	\$59,465	\$48,480	22.66%
Audit Expenses	26,460	22,493	17.64%
Legal Fees	156,711	222,806	-29.66%
Trustee Education	496	0	100.00%
Fiduciary Insurance	55,212	50,561	9.20%
Election Service Payroll	994	880	12.95%
Medical Evaluations	800	2,400	-66.67%
Meeting Expenses	276	355	-22.25%
Pre-Retirement Counseling	4,409	0	100.00%
<u>BENEFITS ADMINISTRATION</u>			
Outsourced Payroll	13,742	13,468	2.03%
Benefit Statements	537	539	-0.37%
Annual Reports	6,442	4,108	56.82%
<u>ADMINISTRATIVE OPERATIONS</u>			
Advertising	0	1,802	100.00%
Office Supplies	1,456	2,542	-42.72%
Postage	3,396	4,901	-30.71%
Printing	1,505	2,192	-31.34%
Publications	2,911	681	327.46%
Dues	835	700	19.29%
Rent	30,555	31,700	-3.61%
Furniture/Fixtures	0	1,310	00.00%
Depreciation	54,432	52,501	3.68%
Insurance	2,967	5,208	-43.03%
Utilities	4,047	1,936	109.04%
Records Processing	3,000	2,500	20.00%
Salaries	156,548	147,823	5.90%
Benefits	49,319	31,379	57.17%
Administrative Travel	518	0	100.00%
Equipment Maintenance	3,214	3,506	-8.33%
Equipment Leasing	3,573	3,034	17.77%
Information Technology	10,357	15,822	-34.54%
Pension Software Maintenance	15,218	14,775	3.00%
Janitorial	3,900	3,900	0.00%
Special Projects *	0	28,122	00.00%
Miscellaneous	162	459	-64.78%
TOTAL	\$673,457	\$722,883	-6.84%

*Web portal development

Schedule by Department of Active and Retired Members

FOR PERIOD ENDING DECEMBER 31, 2004

OFFICE/DEPARTMENT	ACTIVE OR VESTED	RETIRED
Assessors Office	7	5
Airport Authority	72	10
Building Department	22	8
Cemetery Department	14	9
CIP - (Inactive, Now Elderly Services)	1	2
City Clerk's Office	20	8
City Coordinator	1	0
City Solicitor's Office	12	2
District Court	3	1
Employee Assistance Program	1	0
Elderly Services	4	1
Environmental Protection Division	43	8
Finance Department	13	3
Fire Department - (Non- NHRS Group II)	19	3
Fleet Management	0	1
Health Department	71	23
Highway Department	171	63
Human Resources	12	6
Industrial Council	0	1
Information Systems	22	1
City Library	40	19
Mayor's Office	4	4
Manchester Economic Development Office	2	0
Municipal Facilities - (Inactive)	0	2
Office of Youth Services	9	3
Parking	1	1
Parking Meters	0	4
Parks & Recreation	41	20
Public Building Services	20	63
Planning Board	14	1
Police Department - (Non- NHRS Group II)	69	7
Probation Department	1	1
Retirement - (Inactive)	1	2
Risk Management	2	0
School Department	472	87
School Food & Nutrition Services	113	105
Tax Collector's Office	11	4
Traffic Department	15	3
Voter Registration - (Now part of City Clerk)	0	1
Water Works Department	87	35
Welfare Department	11	2
TOTAL	1421	519

CITY OF MANCHESTER EMPLOYEES' CONTRIBUTORY RETIREMENT SYSTEM

Comparative Statements of Net Assets Available for Benefits

DECEMBER 31, 2004 AND 2003

	2004	2003
ASSETS		
Cash	\$ 852,634	\$ 1,525,395
Investments, at fair value		
Equity funds	36,880,436	33,665,369
International funds	13,570,818	12,776,991
Alternative equity	1,773,993	3,022,429
Fixed income	21,138,575	17,872,994
Emerging market funds	4,607,067	4,270,282
Real estate	2,632,841	2,317,989
Timberfunds	4,929,760	4,332,536
Specialty investments	<u>18,619,066</u>	<u>16,323,295</u>
TOTAL INVESTMENTS	<u>104,152,556</u>	<u>94,582,885</u>
Receivable for investments sold	0	129,655
Accrued interest	14,058	9,928
Employee contribution receivable	9,318	6,413
Employer contribution receivable	1,674,982	28,350
Equipment, net of accumulated depreciation of \$178,958 and \$124,526 for 2004 and 2003, respectively	171,928	215,971
Other assets	<u>8,300</u>	<u>0</u>
TOTAL ASSETS	<u>\$106,883,776</u>	<u>\$96,498,597</u>
LIABILITIES AND NET ASSETS		
Payable for investments purchased	35,735	333,230
Accounts payable and accrued expenses	164,516	116,863
Pension benefits payable	<u>439,082</u>	<u>415,761</u>
TOTAL LIABILITIES	639,333	865,854
<i>Commitments and contingencies (notes 6, 7, and 9)</i>		
Net assets held in trust for pension benefits	<u>106,244,443</u>	<u>95,632,743</u>
(See schedule of funding progress on page 30)		
TOTAL LIABILITIES AND NET ASSETS	<u>\$106,883,776</u>	<u>\$96,498,597</u>

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

CITY OF MANCHESTER EMPLOYEES' CONTRIBUTORY RETIREMENT SYSTEM

Comparative Statements of Changes in Net Assets Available for Benefits

YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
Net assets at beginning of plan year	\$95,632,743	\$74,796,544
Increase in net assets attributed to investment income		
Interest	10,843	193,160
Dividends	1,249,771	832,893
Realized gain on sale of investments	10,045,426	1,694,909
Unrealized gain in market value	45,569	19,499,825
Other investment income	37,710	18,388
	11,389,319	22,239,175
Less investment expenses		
Investment management fees	389,308	335,641
Investment advisor expense	44,839	40,892
Custodial fees	70,474	72,344
	504,621	448,877
NET INVESTMENT INCOME	10,884,698	21,790,298
Contributions		
Employer	3,915,053	3,323,023
Employee	1,659,337	1,567,446
Buybacks	35,928	10,773
	5,610,318	4,901,242
TOTAL CONTRIBUTIONS	5,610,318	4,901,242
TOTAL INCREASES IN NET ASSETS	16,495,016	26,691,540
Reduction in net assets attributed to		
Benefits to participants	5,009,300	4,877,225
Refunds of employee contributions plus interest	200,559	255,233
Administrative expenses	673,457	722,883
	5,883,316	5,855,341
TOTAL REDUCTIONS	5,883,316	5,855,341
Net increase in net assets	10,611,700	20,836,199
NET ASSETS AT END OF PLAN YEAR	\$106,244,443	\$95,632,743

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

— Notes to Financial Statements —

DECEMBER 31, 2004 AND 2003

1. DESCRIPTION OF PLAN

The following brief description of the City of Manchester Employees' Contributory Retirement System (the Retirement System) is provided for general information purposes. Participants should refer to the plan document for more information.

■ GENERAL

The City of Manchester, New Hampshire (the City) established a single employer, public employee retirement system on January 1, 1974 to provide pension benefits for certain City employees. The Retirement System is a discretely presented component unit of the City's general purpose financial statements.

The Retirement System adopted Statement No. 34 of the Governmental Accounting Standards Board: "Basic Financial Statements and Management's Discussion and Analysis (MD&A) for State and Local Governments", effective December 31, 2001. The only significant impact of this adoption is the inclusion of the MD&A report as an integral part of the financial statements.

At January 1, 2004 and 2003, the Retirement System membership consisted of:

	2004	2003
Retirees and beneficiaries currently receiving benefits	509	499
Terminated vested members	68	103
Active members	<u>1,316</u>	<u>1,291</u>
Total Participants	1,893	1,893

■ ADMINISTRATION

The Retirement System is administered by a Retirement Board of Trustees (the Board of Trustees) consisting of seven members. They are: (1) the City's Finance Director; (2) a person appointed by the Board of Mayor and Aldermen; (3) and (4) two citizens of the City, one appointed by the Mayor and one elected by the employees, neither of whom shall be an officer or employee of the City or a member of any commission of the City; and (5) and (6) two members who are employees of the City and elected by the membership of the Retirement System. The seventh Trustee is the Mayor of the City who is an ex officio member and can vote only to break a tie. The Board of Trustees is responsible for the operation of the Retirement System.

Duties of the Board of Trustees include overseeing investments, approving the actuarial valuation of the Retirement System, including the actuarial assumptions, interpreting statutory provisions, authorizing benefit payments, and formulating administrative policies and procedures.

The daily administrative functions of the Retirement System have been delegated by the Board of Trustees to the Retirement Office. The Retirement Office processes all requests for retirement, maintains member records, and serves as the Retirement System's information center.

All employer and employee contributions are deposited in a trust fund managed and controlled by the Board of Trustees. The Board of Trustees has appointed professional investment managers who are directed to invest the assets of the trust funds in high quality stocks, bonds, and other investments.

■ ELIGIBILITY AND PENSION BENEFITS

Except as described in the following sentence, the Retirement System applies to all full-time and permanent employees of the City, including elected and appointed officials. The Retirement System does not cover certain categories of employees, such as temporary employees, members of boards and commissions who are not full-time or permanent part-time employees of the City, members of the fire and police departments who are eligible to participate in a state-administered retirement system, and other persons who are, or were, eligible to participate in the New Hampshire Retirement System.

All covered employees hired after January 1, 1974 are required to participate in the Retirement System as a condition of employment. Employees are 100% vested after five years of service. The normal retirement age is 60 and the benefit is calculated at 1.5% of final average total compensation during the highest three years of service in the last ten years of service (hereafter final average earnings) multiplied by the years of service. The benefit was increased to 2% for service completed after January 1, 1999. Permanent employees of the City of Manchester prior to January 1, 1974 who were in service as of January 1, 1974, are eligible for early retirement if credited with no less than twenty (20) years of service.

Such early retirement benefit shall be equal to the greater of: (i) fifty percent (50%) of the member's final average earnings, or (ii) the sum of the member's years of service multiplied by one and one-half percent (1.5%) of the member's final average earnings (2% for service completed after January 1, 1999). Members enrolled subsequent to January 1, 1974 are eligible for early retirement benefits if their years of age plus service are equal to or greater than 80, or if they have attained age 55 with 20 years or more of service. All eligible employees are required to contribute 3.75% of their salaries to the Retirement System. If an employee leaves covered employment or dies before five years of service, the Retirement System refunds accumulated employee contributions and their earnings, calculated at the rates determined annually by the Board of Trustees (5% for 2004). The City is required to contribute the remaining amounts necessary to finance the benefits for its employees. Benefit provision and employee contribution changes require amendment of Chapter 218 of the City Charter, first by enabling legislation by the New Hampshire legislature and then subject to approval of the voters of the City through referendum.

■ DISABILITY RETIREMENT

If a participant becomes totally and permanently disabled from a job-related incident, there is no service or age requirement and the minimum benefit is 50% of the final average earnings.

For a non job-related incident, the disability benefits are payable only if 15 years of service have been rendered and are based on the accrued benefit to the date of disability.

■ COST OF LIVING ADJUSTMENTS

Cost of living adjustments (COLA) are granted pursuant to Administrative Rule 7 by the Board of Trustees. A 4.5% COLA was granted effective July 1, 2004 to all retirees or beneficiaries retired as of December 31, 2003. The effect of the COLA was to increase the actuarial accrued liability at December 31, 2004 by approximately \$1,800,000. This increase will be funded over thirty years. No COLA was granted in 2003.

■ SYSTEM TERMINATION

In the event the Retirement System is discontinued, members' retirement benefits will automatically become 100% vested to the extent they are funded. Members' termination benefits will be paid from plan assets to the extent accrued under the Retirement System's terms and in accordance with applicable laws.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in accordance with Governmental Accounting Standards Board Statements No. 25 and No. 34 and reflect the accrual basis of accounting.

■ INVESTMENTS

Investments are reported at fair value, which has been determined based primarily on quoted market prices (see note 3).

Gains and losses on the sale of investments are computed using the specific identification method of determining cost. The net appreciation/(depreciation) in the fair value of investments held by the Retirement System is based on the valuation of investments as of the date of the *Comparative Statements of Net Assets Available for Benefits*.

■ PENSION BENEFITS PAYABLE

Pension benefits are recorded on an accrual basis when due and payable in accordance with the terms of the Plan. Pension benefits payable as of December 31, 2004 and 2003 amounting to \$439,082 and \$415,761 respectively, represents benefits earned by participants that have not been paid as of the end of the year.

■ ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates that affect the reported amounts of assets, liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

■ RECLASSIFICATION OF FINANCIAL STATEMENT PRESENTATION

Certain reclassifications have been made to the 2003 financial statements to conform with the 2004 financial statement presentation. Such reclassifications had no effect on change in net assets as previously reported.

■ RISKS AND UNCERTAINTIES

The Retirement System invests in various securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of net assets available for benefits.

3. INVESTMENTS

Investment managers have discretionary investment powers within guidelines developed by the Board of Trustees.

The accompanying table presents the net appreciation (depreciation), including realized and unrealized, in fair values of the Retirement System's investments during the years ended December 31, 2004 and 2003.

	<u>2004</u>	<u>2003</u>
Equity funds	\$ 4,498,024	\$ 9,736,115
International equity	985,302	3,184,922
Alternative equity	(1,140,644)	254,927
Fixed income	1,641,862	2,285,241
Emerging market funds	921,505	1,554,133
Real estate	288,300	178,128
Timberfunds	597,224	312,376
Specialty investments	<u>2,299,422</u>	<u>3,688,892</u>
TOTAL	<u>\$10,090,995</u>	<u>\$21,194,734</u>

The following table presents the fair value of investments held that represent 5% or more of the Retirement System's net assets available for benefits:

	2004	2003
Income Research Management (Core Bonds Fund)	\$10,227,512	\$ 8,473,434
BIAM Group Trust (Foreign Equity Fund)	n/a	12,776,991
Causeway (Foreign Equity Fund)	7,439,232	n/a
Gryphon International (Foreign Equity Fund)	6,131,586	n/a
Loomis Sayles (Fixed Income Fund)	10,911,063	9,410,488
Mellon EB (Asset Allocation Fund)	9,530,728	8,526,285
Mellon Capital EB (Global Tactical Assets)	9,088,338	7,783,811
State Street Global Advisors (U.S. Large Cap Value Fund) . . .	10,938,450	9,549,832
Turner Investment (Midcap Growth Fund)	7,452,429	6,985,173
n/a – Not applicable in the year in question		

4. CONTRIBUTIONS

The City's funding policy requires contributions to the plan in amounts sufficient to fund the benefits set forth in the plan. The contributions are determined by the Retirement System's Board of Trustees on the basis of the actuary's valuation. Significant actuarial assumptions used to compute the actuarially determined contribution requirements are the same as those used to compute the pension fund obligation.

The City's contributions in 2004 and 2003 were based primarily on actuarial valuations performed as of December 31, 2003 and January 1, 2003. The City's contributions for 2004 and 2003 were in the amounts recommended by the outside actuary. The recommended City contributions for 2004 and 2003 consisted of normal cost of \$3,915,053 and \$3,323,023, respectively, which included amortization of the unfunded actuarial accrued liability (credits) related to actuarial gains and assumption changes. Unfunded prior service costs are being amortized over periods of thirty years. The employer customary contributions represented 8.76% and 8.5% of covered payroll for 2004 and 2003. Effective July 1, 2004, those amounts began being collected on a weekly basis as a percentage of payroll. Total employee contributions for the same periods amounted to \$1,695,265 and \$1,567,446, respectively, and included member payments for buybacks and other permissive service purchases as are authorized by the plan. As a result of conversion to a per pay period method of collecting the employer customary contribution, a receivable of \$1,674,982 was established for salaries paid between January 1, 2004 and June 30, 2004. Collection of the receivable is expected at the start of the City's new fiscal year, beginning July 1, 2005.

On June 23, 1995, the Retirement System purchased from an insurance company a non-participating single premium contract for \$1,943,011 to fund the 1992, 1993, and 1995 COLA benefits granted to current retirees covered by the Retirement System. The Retirement System continues to make the entire monthly payment to retirees; however, the insurance company transfers to the Retirement System the aggregate COLA amount each month.

Beginning July 1, 2004, active members were afforded a new option for a defined contribution overlay to their defined benefit plan but limited statutorily to specific purposes. Eligible members can choose to contribute actuarially determined amounts to either offset early retirement reductions or to approach or attain a 50% average final earnings benefit level. Participation in the program as of December 31, 2004 was insignificant.

5. INCOME TAX STATUS

The Retirement System received a determination letter, dated January 7, 1975, from the Internal Revenue Service that the original plan was qualified under Section 401(a) of the Internal Revenue Code (IRC) and, therefore, was exempt from Federal income taxes under provisions of Section 501(a) of the IRC. The Plan has been amended subsequent to receiving the determination letter. However, the Plan Administrator and the Plan's Tax Counsel believe that the Plan is designed and is currently being operated in compliance with the applicable requirements of the IRC.

6. OPERATING LEASE

In July of 2003, the System entered into a five-year non-cancelable operating lease for office space with Metropolis Property Management Group. The present lease affords the System 2,500 feet of office space with the initial term expiring on June 30, 2008. The System has one option to extend for a three-year period at the end of the initial term. After the initial year, the base rent of \$30,000 per year will be increased on an annual basis by the lesser of the cumulative increase in the Consumer Price Index for All Urban Consumers as published by the Department of Labor for the Manchester, New Hampshire area or 5%. The Retirement System paid \$30,555 and \$31,700 in total rent expense in 2004 and 2003, respectively.

Future minimum lease payments under non-cancelable leases with an initial term of one year or more are as shown here.

Year ending December 31, 2005	\$ 31,110
Year ending December 31, 2006	31,110
Year ending December 31, 2007	31,110
Year ending December 31, 2008	<u>15,555</u>
	<u>\$108,885</u>

7. LITIGATION

The Retirement System participated in various legal actions during 2004 involving alleged behavior on the part of a Retirement System Trustee. These activities included depositions, court hearings and negotiations between parties. The matter in question related to procedural issues and the re-visitation of past administrative events and did not involve the safety and soundness of investments, benefits administration, or the proper accounting of transactions for the pension fund. Although the matter was ongoing at the end of 2004, a settlement was reached early in 2005 and closure on the matter occurred.

8. CONCENTRATION OF CREDIT RISK

At times, the Retirement System maintains cash balances in excess of the amount insured by the Federal Deposit Insurance Corporation. The Retirement System has not experienced any losses in such accounts. The Retirement System believes it is not exposed to any significant risk with respect to these accounts.

9. STAFF RETIREMENT PLAN

During 2003, the System established a defined contribution 401(k) Retirement Plan covering the employees of the System. The System will match up to 4% of the participants' compensation that is contributed to the Plan. Contributions to the Plan by the System totaled \$5,857 and \$5,181 for the years ended December 31, 2004 and 2003, respectively.

*Required Supplemental Information
(Un-audited)*

SCHEDULE OF FUNDING PROGRESS

ACTUARIAL VALUATION DATE	ACTUARIAL VALUE OF PLAN ASSETS	UNFUNDED ACTUARIAL LIABILITY (SURPLUS)	ACTUARIAL ACCRUED LIABILITY	FUNDED RATIO	ANNUAL COVERED PAYROLL	UNFUNDED LIABILITY TO COVERED PAYROLL
01/01/04	\$95,297,689	\$20,954,959	\$116,252,648	82.0%	\$41,998,187	49.90%
01/01/03	89,755,853	16,364,857	106,120,710	84.6%	38,940,104	42.03%
01/01/02	94,812,631	1,457,848	96,270,479	98.5%	38,692,738	3.77%
01/01/01	90,144,513	(3,049,404)	87,095,109	103.5%	35,370,961	-
01/01/00	82,584,305	(3,263,538)	79,320,767	104.1%	29,581,577	-
01/01/99	72,569,967	(1,494,444)	71,075,523	102.1%	28,439,796	-
01/01/98	65,839,177	(4,296,452)	61,542,725	107.0%	26,961,375	-
01/01/97	59,838,164	(3,121,758)	56,716,406	105.5%	24,418,320	-
01/01/96	55,546,837	(2,973,375)	52,573,462	105.7%	23,320,343	-

SCHEDULE OF EMPLOYER CONTRIBUTIONS

YEAR ENDED JUNE 30	ANNUAL REQUIRED CONTRIBUTION	PERCENTAGE CONTRIBUTED
2004	\$3,844,598	101.84%
2003	3,323,023	100%
2002	1,794,576	100%
2001	1,117,163	100%
2000	713,685	100%
1999	796,552	100%
1998	514,216	100%
1997	543,835	100%
1996	504,328	100%

Funded ratio is the actuarial value of assets as a percentage of the actuarial accrued liability.

Actuarial Valuation Method and Assumptions

The Board of Trustees employs an independent actuarial firm to estimate the actuarial present value of accumulated plan benefits and to determine future contribution rates.

Normal cost and the allocation of benefit values between service rendered before and after the valuation date was determined using the individual entry-age actuarial cost method having the following characteristics:

- The annual normal cost for each individual active member, payable from the date of employment to the date of retirement, is sufficient to accumulate the value of the member's benefit at the time of retirement;
- Each annual normal cost is a constant percentage of the member's year-by-year projected covered pay.

The Retirement System currently has a tiered benefit structure with the ultimate tier being more costly than the initial tier. The normal cost is computed based on this tiered structure. As a result, the normal cost rate is expected to increase as the members affected by the initial tier are replaced by new members.

Financing of Unfunded Actuarial Accrued Liabilities

Unfunded actuarial accrued liabilities were amortized by level (principal and interest combined) percentage of payroll contributions over 30 future years.

Actuarial Asset Valuation Method

Last year's valuation assets are increased by contributions and reduced by refunds, benefit payments and expenses. An amount equal to the assumed investment return for the year is then added. Differences between actual return on a market value basis and an assumed return are phased in over a five-year period. The contribution requirements and benefit values of the System are calculated by applying actuarial assumptions to the benefit provisions and member information furnished, using the actuarial cost method described above.

The principal areas of financial risk which require assumptions about future experience are:

- long-term rates of investment to be generated by the assets of the System,
- patterns of pay increases to members,
- rates of mortality among members, retirees and beneficiaries,
- rates of withdrawal of active members,
- rates of disability among members,
- the age patterns of actual retirement.

In a valuation, the monetary effect of each assumption is calculated for as long as a present covered person survives—a period of time which can be as long as a century.

Actuarial Assumptions

Actual experience of the System will not coincide exactly with assumed experience, regardless of the accuracy of the assumption, or the skill of the actuary and the precision of the many calculations made. Each valuation provides a complete recalculation of assumed future experience and takes into account all past differences between assumed and actual experience. The result is a continual series of adjustments (usually small) to the computed contribution rate.

From time to time it becomes appropriate to modify one or more of the assumptions, to reflect experience trends (but not random year-to-year fluctuations). Present actuarial methods and assumptions were set by the prior actuary and are believed to be reasonable, in the aggregate. Nevertheless, in 2004 the MECRS underwent an experience study to review methods and assumptions. The study results were accepted in November of 2004 for periods subsequent to the 12/31/2004 valuation.

The rate of investment return was 7.5 percent per year, compounded annually (net of administrative and investment expenses). This assumption is used to make money payable at one point in time equal in value to a different amount of money payable at another point in time. The assumed real rate of return (the net return in excess of the wage inflation rate) is 3.0%.

The rates of salary increase used for individual members are in accordance with the following table. This assumption is used to project a member's current salary to the salaries upon which benefit amounts will be based.

SALARY INCREASE ASSUMPTION FOR AN INDIVIDUAL MEMBER

Sample Ages	Merit & Seniority	Base (Economic)	Increase Next Year
20	1.00%	4.50%	5.50%
25	1.00%	4.50%	5.50%
30	1.00%	4.50%	5.50%
35	0.50%	4.50%	5.00%
40	0.50%	4.50%	5.00%
45	0.50%	4.50%	5.00%
50	0.00%	4.50%	4.50%
55	0.00%	4.50%	4.50%
60	0.00%	4.50%	4.50%

If the number of active members remains constant, then the total active member payroll will increase 4.5% annually, the base portion of the individual salary increase assumptions. This increasing payroll was recognized in amortizing unfunded actuarial accrued liabilities.

The mortality table was the 1983 Group Annuity Mortality Table, set back 0 years for men and 0 years for women.

<i>Single Life Retirement Values</i>				
SAMPLE ATTAINED	PRESENT VALUE OF \$1 MONTHLY FOR LIFE		FUTURE LIFE EXPECTANCY (YEARS)	
	Ages	Men	Women	Men
50	\$138.13	\$147.41	29.18	34.92
55	129.80	141.00	24.82	30.24
60	119.40	132.67	20.64	25.67
65	106.72	122.14	16.69	21.29
70	92.80	109.11	13.18	17.13
75	78.28	94.25	10.15	13.37
80	63.93	79.05	7.64	10.20

This assumption is used to measure the probabilities of members dying before retirement and the probabilities of each benefit payment being made after retirement.

The rates of retirement used to measure the probability of eligible members retiring during the next year were as follows:

ACTIVE MEMBERS RETIRING NEXT YEAR

Ages	% Retiring
50	5%
51	5%
52	5%
53	5%
54	10%
55	10%
56	10%
57	10%
58	10%
59	10%
60	10%
61	10%
62	50%
63	15%
64	15%
65	100%

A *member* was assumed to be eligible for normal retirement after attaining age 60 with 5 or more years of service. A member was assumed to be eligible for early retirement after attaining age 55 with at least 20 years of service or if the sum of age and service is at least 80.

Rates of separation from active membership are shown below (rates do not apply to members eligible to retire and do not include separation on account of death or disability). This assumption measures the probabilities of members remaining in employment.

Sample Ages	% of Active Members Separating Within Next Year	
	MALE	FEMALE
20	10.00%	12.50%
25	8.80%	11.30%
30	6.60%	9.40%
35	4.60%	6.90%
40	3.60%	5.50%
45	2.40%	3.40%
50	0.00%	0.00%

Rates of disability were divided equally between duty and non-duty disability, and are as follows:

Sample Ages	% of Active Members Becoming Disabled Within Next Year	
	MALE	FEMALE
20	0.015%	0.020%
25	0.015%	0.025%
30	0.020%	0.030%
35	0.025%	0.040%
40	0.035%	0.050%
45	0.050%	0.075%
50	0.090%	0.130%
55	0.180%	0.245%
60	0.450%	0.605%

- Expense Load:** None.
- Marriage Assumption:** 100% of males and 100% of females are assumed to be married for purposes of death-in-service benefits. Male spouses are assumed to be Three years older than female spouses.
- Pay Increase Timing:** Beginning of the year. This is equivalent to assuming that reported pays represent amounts paid to members during the year ended on the valuation date.
- Decrement Timing:** Decrements of all types are assumed to occur mid-year.
- Eligibility Testing:** Eligibility for benefits is determined based upon the age nearest birthday and exact fractional service on the date the decrement is assumed to occur.
- Decrement Relativity:** Decrement rates are used directly from the experience study, without adjustment for multiple decrement table effects.
- Decrement Operations:** Disability and withdrawal decrements do not operate after member reaches retirement eligibility.
- Miscellaneous Loading Factors:** None.
- Benefit Service:** Exact fractional service as of the valuation date is used to determine the amount of benefit payable.
- Incidence of Contributions:** Contributions are assumed to be received continuously throughout the year based upon the actual payroll payable at the time contributions are made.

City of Manchester Employees' Contributory Retirement System

THIS REPORT HAS BEEN PREPARED PURSUANT TO CHAPTER 218:6, II,
LAWS OF 1973 OF THE STATE OF NEW HAMPSHIRE, AS AMENDED,
AND IS INTENDED TO SATISFY PUBLIC PENSION PLAN FINANCIAL
REPORTING REQUIREMENTS.

COMPREHENSIVE ANNUAL FINANCIAL REPORT • FOR PERIOD ENDING DECEMBER 31, 2004



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