

## Manchester Employees' Contributory Retirement System

### NOTICE 2005-1

#### Calculation Methodology for the Cost Determination of Upgrading Service Credit Earned Between January 1, 1974 and December 31, 1998

#### I. INTRODUCTION

In response to several requests, the Board of Trustees is pleased to issue Notice 2005-1 which is designed to provide members with information about the service credit upgrade program as well as allow them to estimate their costs to participate in the upgrade program. The legislation enacting the service credit upgrade program, Chapter 159, will be effective July 1, 2005. Chapter 159 allows qualifying members the ability to upgrade service credit earned between January 1, 1974 and December 31, 1998 from a 1.5% rate to a 2% rate. It is expected that early in May of 2005 members will automatically be provided with an official cost for immediate use after July 1, 2005. After that initial automatic notification, members will need to request subsequent official cost estimates for the program. Members can do this by completing an Application for Service Credit Upgrade form and returning it to the Retirement System. As we approach the program implementation date, that form will be available on this website or by calling the office and requesting a copy. The written cost estimate provided to members will be effective for 60 days. For more details on the upgrade program please see Administrative Rule 8 which is also located on this website and is also available in writing by calling the office and requesting a copy.

The information below allows members to estimate the cost of participating in the service upgrade program. Unfortunately, because of the variables associated with the cost calculation, it is not possible to provide members with a formula or chart that will calculate the member's costs with 100% accuracy. The methods provided in this notice are designed to allow members to estimate their costs in advance of the effective date of the service upgrade program and to estimate the increase in their retirement benefits. Because the calculation methods contained in this notice do not provide members with their final upgrade costs, members should not rely on these estimated values and the Retirement System assumes no responsibility for decisions made by members in reliance on these estimates. **Certain Internal Revenue Service limitations may also apply which could prohibit a member from upgrading more than \$42,000 worth of service in any plan year. This limit won't affect many plan participants and we expect to have a definitive position on that issue before the law becomes effective on July 1, 2005.**

**CAUTION:** Because of the size of the tables needed for this process, each table, the pre 1974 hires and post 1974 hires, will be divided onto at least four pages when printed, even if 8 ½" x 14" paper is used. Please be very careful to properly align the respective pages to avoid accidentally working with an incorrect set of values.

## **II HOW DOES A MEMBER ESTIMATE THE COST OF PARTICIPATING IN THE SERVICE UPGRADE PROGRAM?**

Please do not attempt to perform this calculation unless you have carefully read and understand the introduction section above.

The calculation process requires that you determine your age at the time of the calculation, the amount of service credit you have in the plan at the time of the calculation, and your present annual salary at the time of the calculation. When we do your official calculation for you and send you an official notification of your cost, we will be using the most up to date values and will guarantee each upgrade cost calculation for 60 days. For the purposes of the exercise below, you will need to choose an age which assumes the calculation is being done on your birthday. You will also need to choose a number of years of service which assumes that you are doing the calculation on your anniversary date. Since either of those assumptions is likely to be true, the actual results will vary accordingly.

There are two age and service charts available on this website. One is for persons hired prior to January 1, 1974 and the other is for persons hired after that date. ***If you were hired prior to January 1, 1974 and had a break in service for any reason, you cannot estimate the cost yourself. Contact the retirement office if you fall into this category.*** If you are older than 60 years of age, you will note that the table values are the same on both charts but for those under age 60, it is imperative that you use the appropriate chart or your results will be incorrect. You may want to print the chart which you will need for your calculation.

Using the appropriate chart, begin by locating the row for your present age in the "Age at Time of Upgrade" column. Then follow that line across to where it intersects with the column for your present "Service at Time of Upgrade". Record the value at that intersection and expressing it as a decimal, (5.65 would be expressed .0565) multiply that value by your present annual salary. (DO NOT try to factor in severance pay or other salary considerations for this part of the calculation. The salary value you use should be roughly 52 times your weekly gross or what you believe that weekly gross will be in July of 2005 if you anticipate an increment or COLA by that time). The results of your calculation will be 100% of the cost of upgrading one full year of pre 1999 service credit.

To obtain your member's share, multiply that results by .5 to get your incremental cost per year. Then, assuming that you are electing to upgrade the time in its entirety, multiply that answer times the number of years of service credit you have between January 1, 1974 and December 31, 1998 to determine your total upgrade cost estimate. You will be allowed to upgrade your time in total or in portions but not in increments of less than one plan year at a time. Because payments must be made in a lump sum, the use of payroll deductions to pay for your upgrade will not be possible since the cost of upgrading a year in most cases will exceed net pay for any week.

### **III HOW MUCH WILL A MEMBER'S ANNUAL BENEFITS INCREASE IF A MEMBER PARTICIPATES IN THE SERVICE UPGRADE PROGRAM?**

The simplest way to estimate the amount of your benefit increase is to multiple your number of years of service between January 1974 and December 1998 by .5 and then multiply those results by your average final earnings. Examples of how to do this calculation are provided further below.

### **IV HOW DOES A MEMBER DECIDE WHETHER TO PARTICIPATE IN THE SERVICE CREDIT UPGRADE PROGRAM?**

To determine whether this program is financially attractive to you, you will need to compare the cost of participation with the increase in annual benefits which the upgrade will provide. In addition, you will need to take into account the other uses of your financial resources, taxes, the time value of money, how long you will remain in city employment, your life expectancy as well as a number of other factors. Because of the complexity involved, the MECRS strongly recommends that you seek the opinion of a licensed financial adviser in making a decision on whether or not to participate in this program and that any actual decisions be based upon the official cost notification which you will eventually receive and not the imperfect estimate derived through the use of the process described here.

### **V EXAMPLES OF CALCULATIONS**

**1. PRE 1974 MEMBER:** Sally was hired on July 1, 1970 on her 20<sup>th</sup> birthday, never experienced any breaks in service, anticipates a weekly gross pay on July 1, 2005 of \$1,000, and wishes to estimate the cost/benefit of upgrading her pre 1999 service. This would give Sally 35 years of service as of July 1, 2005, make her 55 years old on that date, give her a \$52,000 annual salary, and make her eligible to upgrade the entire 25 years between January 1, 1974 and December 31, 1998.

Section 1: Estimating Sally's cost to upgrade service...

1. Go to the pre 1974 spreadsheet.
2. Locate 55 years of age in the left most column.
3. Follow that row across to the 35 year service credit column.
4. Note the multiplier of 5.52
5. Multiple \$52,000 by .0552 and multiple the results by .5, (\$1,435.20)
6. \$1,435.20 is Sally's 50% cost to upgrade one full year of pre 1999 time.
7. \$1,435.20 multiplied by 25 years equals \$35,880 which is her cost to upgrade all of her time.

Section 2: Estimating the amount of Sally's benefit increase if she participates in the program...

1. This simplified process makes no assumption as to Sally's present annual benefit entitlement and focuses instead on estimating the amount that her present benefit would increase by. There is an important value which Sally will need in order to perform this calculation, that being, an estimated "average final earnings", (AFE) figure. For our example we will assume that the three highest years of career salary for Sally were \$50,000, \$51,000 & \$52,000 and that she had no severance pay, (just to make the math easier). Sally would therefore have an AFE of \$51,000. ( $\$50,000 + \$51,000 + \$52,000$  divided by 3).
2. Next, Sally will need to determine the number of years which she intends to upgrade, (in our example that would be all 25 years).
3. Multiply the number of years being upgraded by .5 and then by the average final earnings value you used in Section 2, Step 1. The results of this step will tell Sally what her estimated annual increase attributed to the service upgrade will be.
4. This is .5 times 25, or .125 times 51,000 or \$6,375 per year more than without the upgrade.

*Whether the upgrade is a good investment is a question we will allow Sally and her financial advisor to determine as that is not within the scope of services offered by the retirement system.*

**2. POST 1974 MEMBER:** Ed was hired on July 1, 1980 on his 30<sup>th</sup> birthday, never experienced any breaks in service, anticipates a weekly gross pay on July 1, 2005 of \$600, and wishes to upgrade his pre 1999 service. This would give Ed 25 years of service as of July 1, 2005, make him 55 years old on that date, give him a \$31,200 annual salary, and make him eligible to upgrade the entire 19 years and six months between July 1, 1980 and December 31, 1998.

Section 1: Estimating Ed's cost to upgrade service...

1. Go to the post 1974 spreadsheet.
2. Locate 55 years of age in the left most column.
3. Follow that row across to the 25 year service credit column.
4. Note the multiplier of 4.97
5. Multiple \$31,200 by .0497 and multiple the results by .5, (\$775.32)
6. \$775.32 is Ed's 50% cost to upgrade one full year of pre 1999 time.
7. \$775.32 multiplied by 19.5 years equals \$15118.74 which is his cost to upgrade all of his eligible time.

Section 2: Estimating the amount of Ed's benefit increase if he participates in the program...

1. This simplified process makes no assumption as to Ed's present annual benefit entitlement without exercising the upgrade option and focuses instead on estimating the amount that his present benefit would increase by. There is an important value which Ed will need in order to perform this calculation, that being, an estimated "average final earnings", (AFE) figure. For our example we will assume that the three highest years of career salary for Ed were \$30,200, \$31,200 & \$32,200 and that he have no severance pay, (just to make the math easier). Ed would have an AFE of \$31,200. ( $\$30,200 + \$31,200 + \$32,200$  divided by 3).
2. Next, Ed will need to determine the number of years which he intends to upgrade, (in our example that would be all 19.5 years).
3. Multiply the number of years being upgraded by .5 and then by the average final earnings value you used in Section 2, Step 1. The results of this step will tell Ed what his estimated annual increase attributed to the service upgrade will be.
4. This is .5 times 19.5, or .0975 times 31,200 or \$3,042 per year more than without the upgrade.

*Whether the upgrade is a good investment is a question we will allow Ed and his financial advisor to determine as that is not within the scope of services offered by the retirement system.*

## **VI DISCLAIMER**

**The results of any calculations based on information above are for approximation purposes only. The upgrade program pursuant to Chapter 159 Laws of 2004 only goes into effect as of July 1, 2005 and calculations other than those which will be issued by the Retirement System via US mail are not official and the retirement system is not responsible for decisions made or conclusions drawn from the above processes.**