SOUTHEAST METRO STORMWATER AUTHORITY
RETIREMENT PLAN REVIEW PROJECT & ANALYSIS
DECEMBER 6, 2006

OVERVIEW

Chad J. Larsen of Moreton Financial Solutions, LLC/National Retirement Partners has been engaged by SEMSWA to provide an independent review and analysis of the new organization's options related to the retirement program. This report consists of the following information which was outlined in the engagement letter:

1. Perform a survey and analysis of pension/retirement plans for SEMSWA.
2. Such survey, analysis, and general observations and recommendations shall be completed prior to January 1, 2007 and be presented to the Board of SEMSWA in the form of a written report at a meeting of the Board which we will attend.
3. As agreed, we will review a number of comparable entities to SEMSWA and provide retirement plan information for those entities.
4. The provision of the IGA applicable to providing pension/retirement benefits to SEMSWA employees reads as follows: "benefits that those employees will receive…will be commensurate with those of other governmental entities of similar size, revenue, and budget."

It is important to note that this information is different than the directive to ensure that all employees are "made whole" in the transition. We have not been asked to evaluate individual employee circumstances or projections related to existing and/or potential retirement account outcomes. Our focus has been on the evaluation of several items listed above that affect the overall organization and its retirement programs.

FIDUCIARY RESPONSIBILITIES AND PLAN DECISIONS

The fact that SEMSWA has undertaken this review and analysis of the type of retirement program that it would like to implement is a good indication that the organization is committed to meeting its ongoing fiduciary duties as a plan sponsor. The following is a brief summary of the fiduciary issues that many plan sponsors don't fully understand and in many cases don't fulfill.

The purpose of every plan sponsor should be to ensure that the goals and objectives of the organization's retirement plan are met and that the sponsoring entity, and any individual fiduciaries, are doing everything possible to meet their ongoing fiduciary responsibilities. Typically, a fiduciary is defined as follows, "any person who exercises any discretionary authority or control over the management of the plan or its assets."

The following is a list of the basic fiduciary duties and obligations:

1. Act in the exclusive interest of participants and control expenses of administration;
2. Make decisions with a level of care that a prudent person *familiar with retirement plans* would use under the same circumstances;
3. Provide opportunities for participants to diversify investments to minimize the risk of large losses;
4. Act according to the terms of the written plan documents; and
5. Not engage in any prohibited transactions.

In addition to these items, it is also incumbent upon plan sponsors to review and monitor the investment options that they provide to their employee participants. This review and monitoring is an ongoing requirement for plan sponsors.

Our recommendation is for plan sponsors to establish a "process" in which they are documenting their decision making process related to their plans. This "process" typically requires an employer to establish a retirement plan committee that will commit to meet at least annually to review the plan specifics. These meetings should be documented with meeting minutes and outlines of specific decisions that are made regarding the plans.

Part of the ongoing "process" is to design and draft an Investment Policy Statement (IPS). The IPS is a governing document used by committees to outline the process in which the committee will monitor the plan for the participants.

KEY RETIREMENT PLAN DECISIONS

A few key preliminary decisions that we would encourage the Board to make with regard to the retirement plan can be outlined as follows:

1. Should SEMSWA elect to participate in Social Security for its employees or structure a "replacement plan" in lieu of Social Security?
2. Does SEMSWA wish to pursue a defined benefit or a defined contribution approach to its retirement program for its employees?
3. What is the funding philosophy, strategy, and funding amount that SEMSWA would like to incorporate into their retirement program?
4. Does SEMSWA wish to structure its own retirement investment vehicle/program or elect to participate in other programs that are available for governmental entities?

Although there are many key elements related to the establishment and ongoing maintenance of a retirement program, these key decisions will determine to a large degree the type, form, and structure of the program that will be the best fit for your organization. Many of the specific plan provisions, investments, and administrative issues can be easily adapted once these key decisions are made.

Social Security Participation

The decision to participate in Social Security or elect a replacement plan will have a significant affect on the overall retirement program that SEMSWA implements. As you can imagine, this decision is not an easy one and there is no "one size fits all" answer to this decision. There are many factors to consider and this engagement does not include an exhaustive analysis of this question for SEMSWA. The following are some of the pros and cons that are typically discussed when this decision arises (discussion only of the retirement portion of Social Security):

Pros of Social Security Participation

- Most employees are familiar with the system and have a fair understanding of the system.
- Retirement income and benefits are payable for the life of the recipient.
- Benefits have historically been indexed for cost of living adjustments over time.
- There are survivor and beneficiary benefits that often aren't fully understood or appreciated.
- Most participants consider their benefits to be "safe" and "guaranteed".
- Retirement benefits are typically not taxed (some exceptions apply) when they are received.

Cons of Social Security Participation

- Contributions are not considered pre-tax for income tax purposes.
- The participants do not have any say or control over their accounts and the growth of their accounts.
- The benefit formulas and replacement ratios typically favor lower paid workers.
- Employees can't receive retirement benefits prior to age 62.
- Politicians control the funding and future changes to the system and funding concerns are well documented based upon the demographics of the participants in the program.

A Gallup poll indicated that nearly two-thirds of all Americans currently participating in Social Security would elect to "opt-out" if they were given the opportunity to do so. Nearly one-third of the respondents indicated that they would elect to "opt-out", even if it meant that they would forfeit everything they had already contributed to the system to that point.

Some of the pros and cons of electing a "replacement plan" are as follows:

Pros of a Replacement Plan

- Greater flexibility in both employer and employee funding and plan design provisions (i.e., early retirement provisions, contribution rates, etc.).
- Opportunity for more employee control and management.
- Potential for greater benefits based upon actual experience.
- Greater opportunity for investment elections based upon participant objectives or needs.
- Some participants may still be eligible for Social Security benefits based upon previous or post work experience (although S.S. benefits may be reduced).
- Employee contributions are typically considered pre-tax for income tax purposes.

Cons of a Replacement Plan

- If lump-sum or period-certain annuity distribution options are available, participants may not have a guaranteed income for life and could potentially run out of funds.
- Income received from the plan is considered taxable income at the time of distribution.
- Some replacement plans may not fund adequately to match the participants potential benefits of Social Security.
- Some participants may invest poorly which could significantly affect their retirement benefits.
- Creates some potential confusion for participants that are not familiar with the coordination issues and the "Windfall Elimination Provision" (Copy Attached).
- Typically requires greater involvement from the organization to monitor and manage the replacement plan.
- The organization must still interact with the Social Security Administration and fund the medicare portion of the plan.

Defined Benefit vs. Defined Contribution

As you know, there are significant differences between the two approaches and there are also many "hybrid" approaches that have been used by many entities to accomplish their specific objectives. A "hybrid" plan often has some of the features and benefits of both a defined contribution and a defined benefit plan.

The vast majority of new plans being implemented today are defined contribution plans for the following reasons:

- Ease and overall cost of administration versus defined benefit plans.
- Portability and flexibility for participants to take their accounts when they leave.
- Transfers the investment risk and therefore much of the funding risk to the employees.
- Simplified budgeting and funding calculations and projections.
- Greater awareness and appreciation from the general employee workforce.

This decision whether to select a defined benefit or defined contribution approach is a philosophical one based upon the organization's primary objectives and goals for its plan. Although I can offer my suggestion and recommendation, I would caution that whatever plan structure or design is selected by the Board, it should be closely aligned with the organization's overall objectives and philosophy of what they are hoping to accomplish with the retirement program.

FUNDING PHILOSOPHY AND STRATEGY

The following information has been compiled to assist in the comparisons and benchmarking of other organizations that might be considered comparable in some ways to SEMSWA.

Retirement Provisions	Arapahoe County	Urban Drainage and Flood Control	East Cherry Creek Valley W&S District	Arapahoe County W&W Authority	Parker Water & Sanitation District	Town of Parker	Eagle River Water & Sanitation District	City of Centennial
Participate in Social Security	Yes	No	Yes	No	No	No	No	No
Defined Benefit Plan	Yes - Hybrid	No	No	No	No	No	No	No
Defined Contribution Plan	No 401(a) Yes 457	401(a) & 457	401(a) & 457	401(a) & 457	401(a) & 457	401(a) & 457	401(a) & 457	401(a) & 457
Employer Total Contribution w/ 6.2% SS if Applicable. (SSRP = Social Security Replacement Plan)	6.5% * + 6.2% SS **12.7% Total**	4% - 401(a) 2% - 457 7.65% - SSRP **13.65% Total**	7% - 401(a) 2%* - 457 6.2% - SS **15.2% Total**	12.4%* SSRP + 5% - 401(a) **17.4% Total**	10% - 401(a) 5% Match in 457 **15% Total***	10% - 401(a) **10% Total**	6.2% SSRP + 5% - 401(a) **11.2% Total**	3.75% 401(a) **3.75%**
Employee Mandated Contribution w/6.2% SS if Applicable	6.5%* + 6.2% SS **12.7% Total**	4% - 401(a) 7.65% - SSRP **11.65% Total**	6.2% SS **6.2% Total**	5% **5% Total**	9% - 401(a) **9% Total**	8% - 401(a) **8% Total**	5% - 401(a) **5% Total**	3.75% 401(a) **3.75%**
Total EE & ER Combined Contributions	**25.40%***	**25.30%**	**21.40%**	**22.40%**	**24.0%**	**18.0%**	**16.2%**	**7.5%**
Number of Employees	1800	22	Est. 30	30	60	200	80	35
Estimated Operating Revenue	$300 Million	$	$	$8 Million	$20 Million	$45 Million Estimate	$25 Million Estimate	$40 Million

1. The Arapahoe County current contribution of 6.5% for ER and EE is scheduled to increase up to 8% over the coming three years.
2. The 2% 457 Contribution for East Cherry Creek Valley plan is contingent upon an employee utilizing the other benefits budget made available.
3. The 12.4% Social Security replacement contribution Arapahoe County W&W is considered all ER contribution but was originally contingent upon the EE's passing up an annual bonus payment.
4. The Parker Water & Sanitation District total contribution of 15% includes the 5% match in the 457. If an employee doesn't contribute they would not receive the additional 5%.
5. All information is based upon discussions with representatives from the organizations. Plan documents have not been reviewed to verify these levels.

FUNDING PHILOSOPHY AND STRATEGY (CONTINUED)

Based upon the data and information provided from those entities listed above, we would highlight the following key items:

1. The range in total payroll contributions from the employer only (including SS if applicable), based upon eligible compensation among the eight entities, ranges from a low of **3.75%** to a high of **17.4%.**

2. The range in total payroll contributions from the employee only (including SS if applicable), based upon eligible compensation among the eight entities, ranges from a low of **3.75%** to a high of **12.7%.**

3. The range in total combined employer and employee retirement plan contributions (including SS if applicable), based upon eligible compensation among the eight entities, ranges from a low of **7.50%** to a high of **25.4%.**

It is important to recognize that comparing defined benefit programs to defined contribution programs is not comparing apples to apples. The only reason that the Arapahoe County plan is used in this comparison is due to the fact that employees will be coming from this plan to SEMSWA and that it is a hybrid plan where there is a fixed contribution component that is utilized in the funding arrangement.

Although the budget and operating revenues are listed for the various entities with just a few exceptions, this is for comparison purposes primarily. The reason for this is that in most plans, the determining factor that goes into the funding is based upon the percentage of eligible compensation from the participants and not necessarily the overall budget and revenues of the organization.

If SEMSWA desires to pursue a defined benefit approach, we would suggest additional comparisons be completed with entities that fall within the scope and parameters outlined by the Board. The specific funding projections and/or plan design components are not considered part of this review analysis.

PLAN OPTIONS

Once the key retirement plan decisions listed on page two are agreed upon, then the Board and SEMSWA can look at the specific types of plans, the vendors they may want to consider and the plan provisions and plan design features. Some of the options that we would typically include in the discussion and analysis for governmental entities would include the following:

1. PERA, if a defined benefit component to the retirement benefits is of interest.
2. CCOERA, for a defined contribution approach with an existing platform and program.
3. Individually selected plan (i.e., through ICMA, Great-West Life, Nationwide, Principal, etc.).

As a new entity with little or no plan assets, we would typically suggest looking at an existing program where you may be able to secure a highly competitive plan with reduced administration or investment fees that you may not be able to secure on your own accord. The other factors to consider in the plan option decision are the administrative services and participant services as well as evaluating what level of support you desire with your plan. Specific proposals and/or information should be reviewed and analyzed prior to making a final selection of the specific program or vendor that is selected. We would also encourage a meeting with that vendor to explore and outline all of the fees, expenses, services, and support that SEMSWA could expect going forward.

NATIONAL PLAN BENCHMARKING DATA

We have provided and made available a copy of the 2006 PLANSPONSOR annual benchmarking data for the Governmental and Public Works industry. The survey provides information related to specific industries and compares that industry to "all industries". Some of the information may not be applicable to SEMSWA but there will be some information that may provide a broader perspective of what is happening in the governmental retirement plan markets.

GENERAL OBSERVATIONS/RECOMMENDATIONS

Based upon the information, review, and analysis of the SEMSWA organization and the provisions outlined in the IGA applicable to retirement plans, we would make the following suggestions and recommendations:

1. As a new governmental entity with the option of electing to either participate in Social Security or offer a replacement plan, we would suggest that SEMSWA offer a replacement plan for its employees. It is our understanding that SEMSWA has, or will, evaluate how such a decision may ultimately affect the employee participants. If this decision is made, I would also encourage the Board to ensure that there is adequate education and communication to the employees to help them understand the specifics of this election.

2. As a new entity with approximately 10 to 20 employees, our recommendation on plan structure would be to adopt a defined contribution plan for your retirement program. For governmental entities this would typically include a 401(a) and 457 plan along with the replacement plan outlined above. Most, if not all, of the potential vendors that you would consider should have sample or prototype documents that would be available and this should minimize the implementation and ongoing costs of such a plan structure.

3. Based upon the entities reviewed and our analysis and experience, we would make the following recommendation as to the funding levels to consider for the retirement program. We looked at the eight entities and eliminated both the high and low figures and looked at the remaining averages to come up with the following:

a. Employer Contribution Total (includes Social Security if you elect to participate): The average was approximately 13% total employer contribution***. Our recommendation would be an employer contribution of 15%***.
b. Employee Required Contribution Total (includes Social Security if you elect to participate): The average was approximately 7.5%. ***Our recommendation would be to have employee contributions of 8% total***.
c. Total Retirement Plan Contributions (includes Social Security if you elect to participate): The average was approximately 21% total. ***Our recommendation would be the combined recommendations listed above which would be 15% employer contribution + 8% employee contribution for a total contribution amount of 23%.***

These recommendations are made with the understanding that SEMSWA has also engaged other consultants to evaluate and look at specific participant retirement data and projections. We have not reviewed or analyzed that data and therefore would encourage SEMSWA to feel comfortable fine-tuning the recommendations listed above if needed to more fully meet their overall plan objectives and goals.

SUMMARY

In completing our project engagement, we have provided you with a broad level view of your key decisions and the comparable funding analysis that can be utilized to help finalize your overall plan objectives and funding strategies.

We appreciate the opportunity to provide you with this review and analysis. If additional assistance is needed to design, or implement your plan, we would be happy to assist as needed.