

Worcester Retirement System
Worcester, Massachusetts
(A Component Unit of the
City of Worcester, Massachusetts)



Comprehensive Annual Financial Report
Fiscal Year Ended December 31, 2005

**Worcester Retirement System
Worcester, Massachusetts
(A Component Unit of the City of Worcester, Massachusetts)**

**Comprehensive Annual Financial Report
For the Fiscal Year Ended December 31, 2005**

**Prepared by the Staff of the
Worcester Retirement System**

Table of Contents

Introductory Section:

- 2. Chairman's Letter
- 4. Letter of Transmittal
- 8. Retirement Board Members
- 8. Administrative Staff
- 8. Organizational Chart
- 9. Consultants and Professional Services
- 10. Certificate of Achievement for Excellence in Financial Reporting

Financial Section:

- 12. Independent Auditors' Report
- 14. Management's Discussion & Analysis
- Basic Financial Statements:**
- 20. Statement of Plan Net Assets
- 21. Statement of Changes in Plan Net Assets
- 22. Notes to Financial Statements
- Required Supplementary Information:**
- 31. Schedule of Funding Progress
- 31. Schedule of Employer Contributions
- 32. Notes to Required Supplementary Information
- Supplementary Information:**
- 33. Schedule of Administrative Expenses
- 34. Schedule of Investment and Consultants' Expenses

Investment Section:

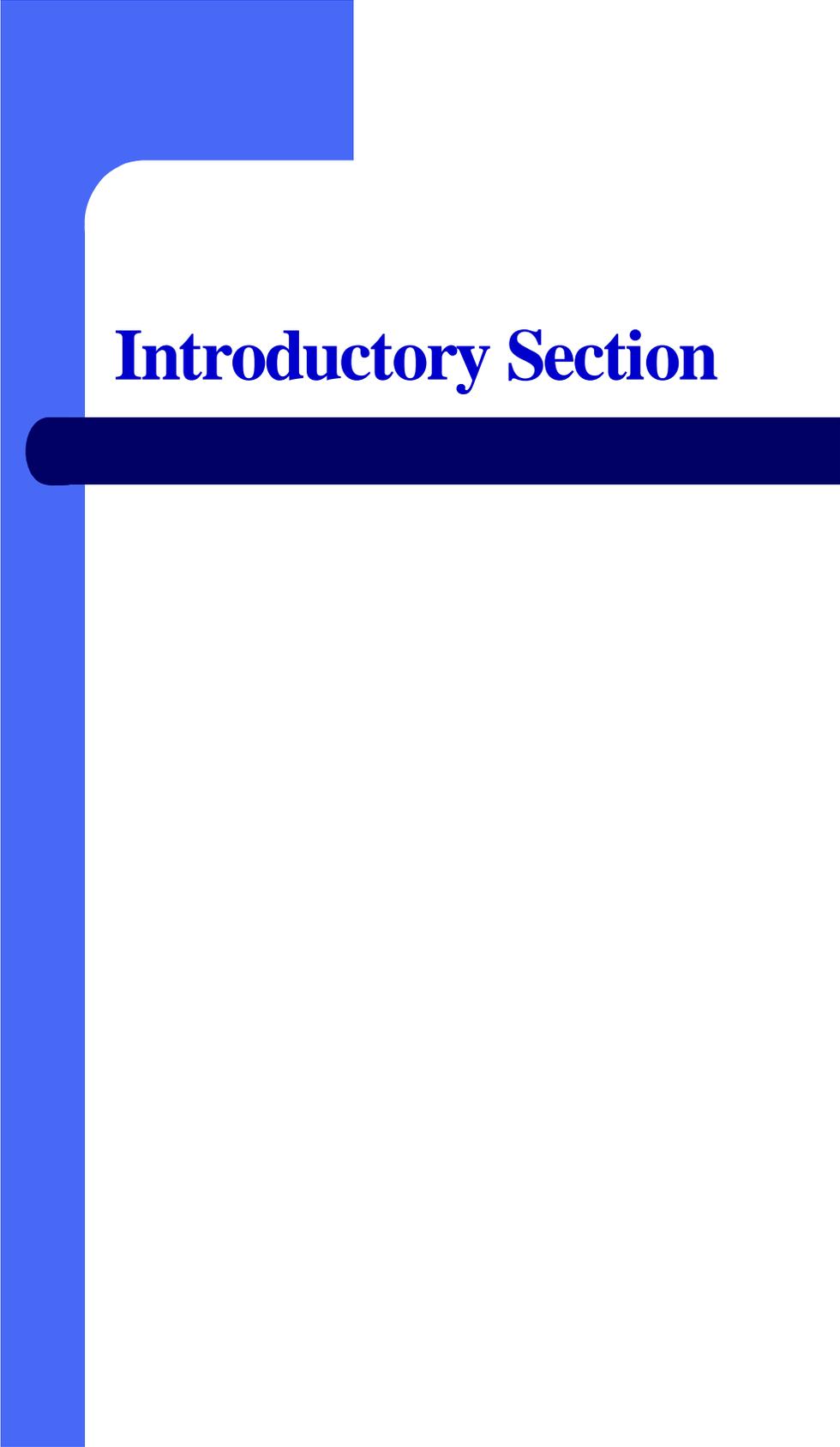
- 36. Report on Investment Activity
- 36. Outline of Investment Policies
- 44. Investment Results
- 45. Asset Allocation
- 48. Ten Largest Stock Holdings by Fair Value
- 48. Ten Largest Fixed Income Holdings by Fair Value
- 49. Schedule of Fees and Commissions
- 50. Commissions to Brokers
- 53. Investment Summary
- 54. Liquidity Profile

Actuarial Section:

- 56. Actuarial Certification Letter (The Segal Company)
- 58. Summary of Actuarial Assumptions and Actuarial Cost Method
- 61. Schedule of Active Member Valuation Data
- 61. Schedule of Retirants and Beneficiaries added to and removed from Rolls
- 62. Solvency Test
- 62. Analysis of Financial Experience
- 63. Summary of Plan Provisions

Statistical Section:

- 67. Schedule of Additions to Plan Net Assets by Source
- 67. Schedule of Deductions from Plan Net Assets by Type
- 68. Schedule of Retired Members by Type of Benefit
- 68. Schedule of Benefit Expenses by Type
- 69. Schedule of Average Benefit Payments
- 69. Schedule of Participating Employers



Introductory Section

Worcester Retirement System

Room 103 City Hall Worcester Massachusetts 01608 Phone (508) 799 1062

Chairman's Letter

June 3, 2006

Dear Members of the Worcester Retirement System:

On behalf of the Worcester Retirement Board (Board), I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the Worcester Retirement System (WRS) for the year ended December 31, 2005. The report is designed to provide a detailed look at the financial, investment and actuarial aspects of the WRS.

A comprehensive report is being issued in the interest of full disclosure to WRS members and to demonstrate the diligent stewardship and internal controls that are in place to protect assets and maintain financial integrity. The last two CAFRs have been awarded the Certificate of Achievement for Excellence in Financial Reporting making WRS one of only four retirement systems in New England to receive this prestigious award, a fact of which we are all very proud. The Board was also honored by being one of "Money Management Letter's" three finalists for the national award of small public pension plan of the year.

The Board typically meets at least twice a month. There is one meeting to discuss benefit issues and at least one other to discuss investment issues and conduct due diligence on those investments. It is the fiduciary responsibility of the Board to ensure that current and future pensions will be paid. Therefore, safeguarding the WRS investment portfolio is a top priority. In that regard the WRS has a policy that incorporates an asset allocation with a 20-year time horizon containing asset classes that involve investment risk to reap the rewards of potential stellar returns but to also diversify those assets to mitigate risks during the inevitable times when certain asset classes experience sub-par returns. During the last year WRS further diversified by increasing its allocation to hedge funds from 2-percent to 5-percent of the portfolio, private equity from 5-percent to 6-percent, and international equities from 17 to 20-percent. These changes were accommodated by reducing allocations to domestic equities and domestic fixed income.

Each of the last three years has produced investment returns in excess of WRS actuarial benchmark yielding an average of 15.5-percent during that time. This performance has come on the heels of the longest and most severe bear market in over 60 years, which occurred during the previous three years.

Last year WRS's Unfunded Actuarial Accrued Liability (UAAL) was reduced from \$165.8m to \$162.9m. Additionally, the assumed rate of return was reduced from 8.5-percent to a more conservative and conventional 8.25-percent. These improvements occurred because of investment gains, an additional \$1.2m contribution from the City and from salary increases that were less than anticipated.

The \$1.2m additional contribution from the City was made possible when they released the funds that were put into a reserve as a requirement of the Pension Obligation Bond legislation. This additional contribution not only helped to reduce the UAAL, but also after being applied to the 2003 Early Retirement Incentive liability reduced the funding schedule related to it from what would have been 13 remaining years to 6 years.

The UAAL was also increased by over \$1m by recently passed legislation. A change in veteran's allowance accepted under Home Rule by the City increased the UAAL by \$371k and legislation passed at the state level increased UAAL by another \$660k. The state legislation updated very outdated mortality tables that were used when calculating survivor benefits under Option C. The more current tables recognize the fact that life expectancy for men had increased in relation to that for women. This change also increased annual normal costs by \$60k.

I would like to thank the other members of the Board for their diligence on retirement matters and the Board's investment consultant, actuary and independent auditors for their assistance with the preparation of this report and advice on other matters. I would also like to thank the Board's legal representatives for their counsel and the Public Employee Retirement Administration Commission for their oversight of our actions.

Finally, I would like to commend the staff of the WRS for their diligent work in preparing this report and their commitment to continually improve administrative operations. I encourage members to carefully review this report, as it contains a wealth of information about your retirement system.

Sincerely,

A handwritten signature in cursive script that reads "James DelSignore". The signature is written in black ink and is positioned above the typed name and title.

James DelSignore, CPA
Chairman

Worcester Retirement System

Room 103 City Hall Worcester Massachusetts 01608 Phone (508) 799 1062

June 15, 2006

Worcester Retirement Board
City Hall Room 103
455 Main Street
Worcester, MA 01608

Dear Mr. Chairman and Members of the Board:

We are pleased to submit the Comprehensive Annual Financial Report (CAFR) of the Worcester Retirement System (WRS) for the year ended December 31, 2005. The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the WRS for its CAFR for the year ended December 31, 2004. This was the second year in a row that the WRS has achieved this prestigious award. In order to be awarded a Certificate of Achievement, the WRS must publish an easily readable and efficiently organized CAFR. This report must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements. Management accepts responsibility for the contents of the report.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

GASB Statement No. 34 requires that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to compliment the MD&A and should be read in conjunction with it. The WRS's MD&A can be found immediately following the report of the independent auditor.

Report Structure

This CAFR is presented in five sections as follows:

Introductory Section, which contains this letter of transmittal, information on the administrative organization, and a letter from the Chairman of the Board.

Financial Section, which contains the report of the Independent Auditors, Management's Discussion & Analysis (MD&A), the basic financial statements of the WRS, related notes and disclosures, required supplementary information, and other supplementary information.

Investment Section, which contains an investment report prepared by the investment consultant, investment policies, investment results, broker fees and schedules.

Actuarial Section, which contains the independent actuary's certification, results of the annual actuarial valuation, and an outline of actuarial assumptions.

Statistical Section, which contains significant data pertaining to the WRS.

History of the WRS

The Commonwealth of Massachusetts Commissioner of Insurance, Charles J. Harrington, issued a certificate declaring the establishment of a contributory retirement system on June 12, 1944 after the City Council approved acceptance of Chapter 32 section 31 (I) of the Massachusetts General Laws (MGL) and the Mayor approved acceptance of sections 26 to 31 (H) inclusive with amendments.

The WRS became operative as of January 1, 1945. The WRS is a contributory defined benefit plan that covers eligible employees of the City of Worcester (except Worcester Public School teachers) and the Worcester Housing Authority (WHA). The WRS is administered by a five member Board consisting of the City Auditor, two representatives elected from the membership, a City Manager representative and a fifth member chosen by the other four who cannot be an employee, retiree or official of the City. The Chairman is elected by the five Board members.

Investment Results

The WRS has an Investment Policy Statement which establishes investment objectives and policies providing the framework for investments. This Policy is reviewed on an annual basis. A summary of Investment Policy is included in the Investment Section. The System uses a custodian bank to safeguard the assets and ensure proper settlement and recording of transactions.

An integral part of the overall investment policy is the asset allocation policy. This is designed to provide an optimal mix of asset classes to both preserve principal and provide adequate funds to pay pension benefits. Both traditional assets (cash, bonds, domestic stocks, domestic fixed income and mortgages) and nontraditional assets (real estate, international stock and fixed income, venture capital, mezzanine financing, hedge funds, timber and leveraged buyouts) are part of the mix. The investment market results for 2005 demonstrate the importance of a diversified asset allocation.

WRS investment return of 9.7% for 2005 exceeds both the actuarial expected rate of return and the investment policy benchmark. This represents the third consecutive calendar year of positive results for the WRS. Please refer to the Investment Section of this CAFR for more information on investment results.

Major Initiatives

Benefits

On December 22, 2004 the Public Employee Retirement Administration Commission voted to approve the new mortality tables authorized by State Legislation, Chapter 149 of the Acts of 2004. The new actuarial equivalent basis is RP-2000 Combined Healthy Table with 50% male and 50% female rates and an interest rate of 7%. This new table reflects more current mortality rates. The change was made retroactive to July 1, 2004.

A cost of living adjustment (COLA) was provided for retirees and survivors effective July 1, 2005. The 3% COLA was paid on a base of \$12,000 (maximum \$360), the most allowed by law. The WRS has granted the maximum increase every year since enactment of the legislation in 1997.

In December 2005 the Retirement Board accepted section one of Chapter 157 of the Acts of 2005. With acceptance by the Worcester City Council the following month the section became effective. The Act provides an additional benefit to disability retirees that were veterans at the time of retirement. The maximum annual increase allowed by this vote was \$300 per retiree.

Administration

The WRS strives to provide quality service and information to active and retired members and their beneficiaries. To assist in this effort, we have maintained and continually update our Internet site through the City web page, which includes our CAFR, at www.ci.worcester.ma.us/ref.

Internal and Budgetary Controls

The WRS management is responsible for maintaining a system of internal controls designed to provide reasonable assurance that the financial statements are fairly stated in accordance with accounting principles generally accepted in the United States of America while adequately safeguarding the assets. We believe the current internal controls accomplish this goal.

The WRS budget is presented to and approved by the Board each year. All the expenditures are reviewed by the Board at its monthly meeting.

Accounting

This report has been prepared in accordance with accounting principals generally accepted in the United States of America. The basic financial statements are presented in accordance with the principles of the Government Accounting Standards Board (GASB), including guidelines established by GASB Statements No. 25, *Financial reporting for defined benefit plans*; No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*; No. 37, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus*, No. 38, *Certain Financial Statement Note Disclosures*; and No. 40 *Deposit and Investment Risk Disclosures (an amendment of GASB No. 3)*.

Sullivan, Rogers & Company, LLC, a firm of licensed certified public accountants, performed the audit for the WRS. The goal of the independent audit is to provide reasonable assurance that the financial statements for the year ended December 31, 2005 are free of material misstatements. The report of the independent auditors is included in the Financial Section of this report. Sullivan, Rogers & Company, LLC has issued an unqualified opinion on the WRS's basic financial statements for the year ended December 31, 2005.

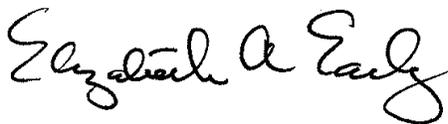
Actuarial Funding

The WRS has retained the services of The Segal Company, an independent actuarial firm, to conduct an annual actuarial valuation of the WRS. The funded ratio is one measure of the financial condition of the WRS. The funded ratio is calculated by dividing the net assets of the WRS by the projected pension liability. The projected pension liability is a measure of the present value of total pension benefits estimated to be payable in the future to both current and future retirees and/or beneficiaries. A higher funding ratio gives the members a greater degree of assurance that their pension benefits are secure. As of January 1, 2006 the funded ratio of the WRS was calculated at 79.81%, a slight increase from the prior year.

Acknowledgements

The publication of this report represents the combined efforts of the WRS Board, staff, Sullivan, Rogers & Company, LLC and consultants. We are proud to present this report to our members. We feel it is important to provide a CAFR for our members and other interested parties to follow the progress of the WRS.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Elizabeth A. Early". The signature is written in a cursive, flowing style.

Elizabeth A. Early
Executive Secretary

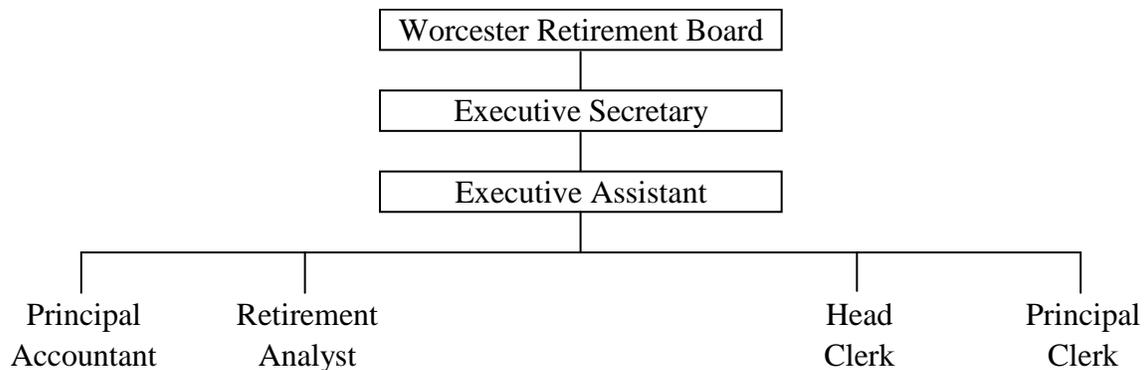
Retirement Board Members

		<u>Terms</u>
James DelSignore	Ex-Officio Member	N/A
Stephen F. Wentzell	City Manager Appointee	At the discretion of the City Manager
Elizabeth A. Early	Elected Member	11/01/2004 - 10/31/2007
Raymond F. McGrath	Elected Member	01/01/2003 - 12/31/2005
Thomas Wade	Appointed Member	01/10/2003 - 01/09/2006

Administrative Staff

Elizabeth A. Early	Executive Secretary
Judith McMillen	Executive Assistant
Donald McLaren	Principal Accountant
Donna McCaffrey	Retirement Analyst
Barbara Zecco	Head Clerk
Eileen Powers	Principal Clerk

Organizational Chart*



* Does not include investment professionals who provide services to the WRS. A list of these investment professionals is located on the following page.

CONSULTANTS AND PROFESSIONAL SERVICES

DOMESTIC EQUITY MANAGERS

The Boston Company Asset Management, LLC
Boston, MA
Columbia Management Advisors, LLC
Hartford, CT
Hutchens Investment Management, Inc.
Concord, NH
Enhanced Investment Technologies, LLC
Palm Beach Gardens, FL
Loomis Sayles & Company, L.P.
Boston, MA
Penn Capital Management Co, Inc
Cherry Hill, NJ
State Street Global Advisors
Boston, MA

DOMESTIC FIXED MANAGERS

OPUS Investment Management, Inc.
Worcester, MA
Loomis Sayles & Company, L.P.
Boston, MA
Merrill Lynch, Pierce, Fenner & Smith
Worcester, MA
The Northern Trust Company
Chicago, IL

INTERNATIONAL EQUITY MANAGERS

Acadian Asset Management
Boston, MA
The Boston Company Asset Management, LLC
Boston, MA
State Street Global Advisors
Boston, MA

**ALTERNATIVE CAPITAL
INVESTMENT MANAGERS**

Ascent Venture Management
Boston, MA
Boston Capital Ventures
Boston, MA
Boston Millennia Partners
Boston, MA
Charlesbank Capital Partners
Boston, MA
Concord Partners L.P.
Wellesley, MA
Duke Street Capital
London, England
Invesco Private Capital, Inc.
New York, NY
New England Partners Capital L.P.
Boston, MA
Northstar Capital, LLC
Minneapolis, MN
Mass PRIM
Boston, MA
Standard Life Investments Limited
Edinburgh, EH2 2LL
The Riverside Company
New York, NY

REAL ESTATE MANAGERS

Bailard Fund Services, Inc.
Foster City, CA
Heitman Investment Management
Chicago, IL
Intercontinental Real Estate Corp.
Boston, MA
L&B Realty Advisors, Inc.
Dallas, TX
RMK Timberland a div. of Regions Bank
Winston-Salem, NC
Mass PRIM
Boston, MA
VEF Advisors, LLC
Atlanta, GA

LEGAL ADVISORS

Kirkpatrick & Lockhart Nicholson Graham, LLP
Boston, MA

INDEPENDENT AUDITORS

Sullivan, Rogers & Company, LLC
Burlington, MA

INVESTMENT ADVISORS

Meketa Investment Group
Braintree, MA

ACTUARIAL CONSULTANT

The Segal Company
Boston, MA

CUSTODIAN

Investors Bank & Trust Company
Boston, MA
State Street Corporation
Boston, MA

COMMISSION RECAPTURE BROKERS

Donaldson & Company
Atlanta, GA
Lynch, Jones & Ryan, Inc.
New York, NY

SECURITIES LENDING

UBS Securities, LLC
Boston, MA

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Worcester Retirement Sytem,
Massachusetts

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

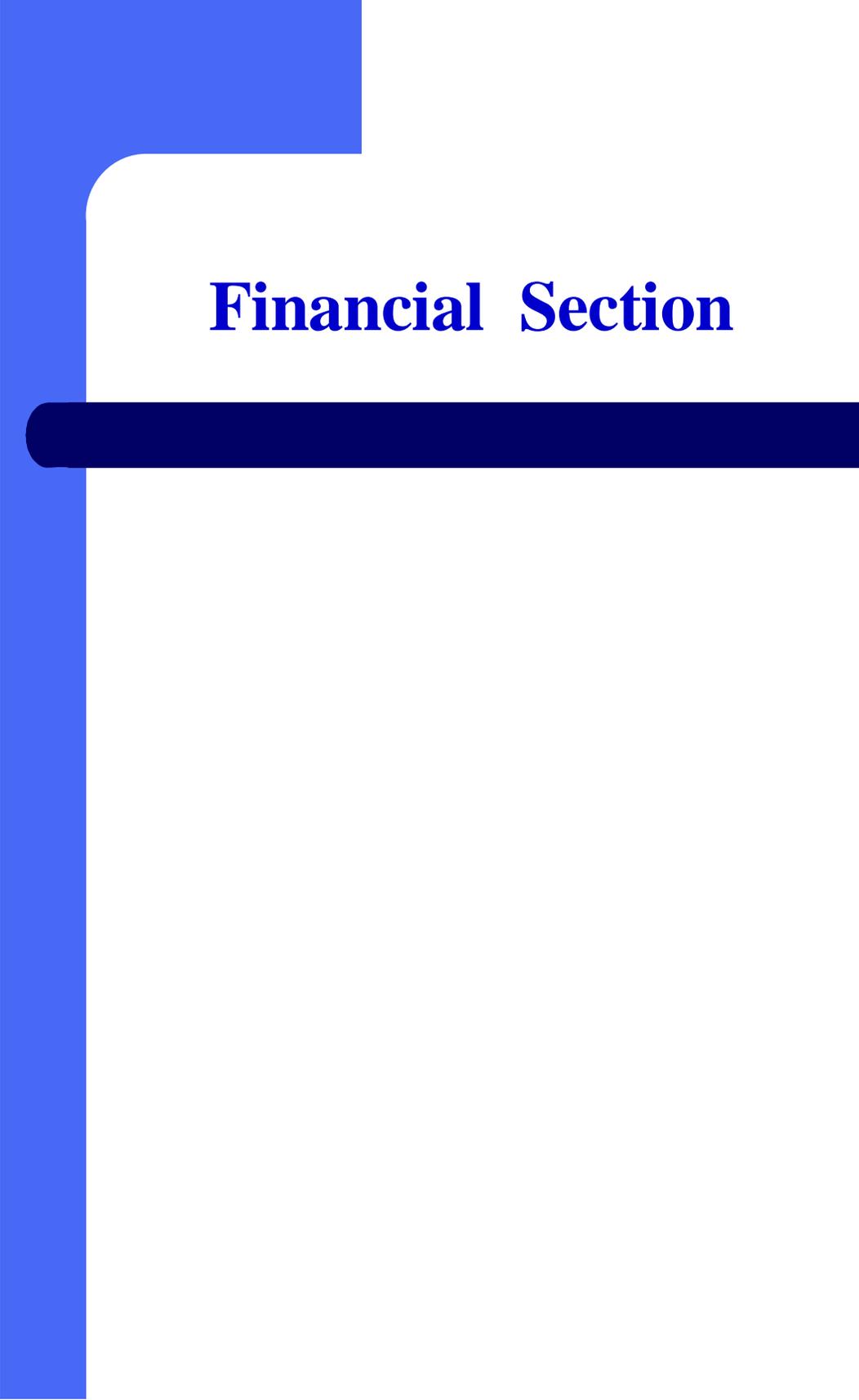


Carla E. Perry

President

Jeffrey R. Egan

Executive Director



Financial Section



Certified Public Accountants

SULLIVAN, ROGERS & COMPANY, LLC

Corporate Place I, Suite 204 • 99 South Bedford Street

Burlington, Massachusetts 01803

P • 781-229-5600 F • 781-229-5610 www.sullivan-rogers.com

Independent Auditors' Report

To the Honorable Retirement Board
Worcester Retirement System

We have audited the accompanying basic financial statements of the Worcester Retirement System (WRS), a component unit of the City of Worcester, Massachusetts, as of and for the year ended December 31, 2005, as listed in the table of contents. These financial statements are the responsibility of the WRS's management. Our responsibility is to express an opinion on these financial statements based on our audit.

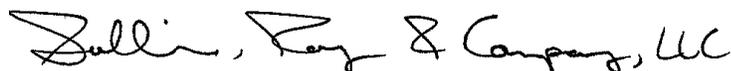
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the WRS as of December 31, 2005, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated May 23, 2006, on our consideration of the WRS'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 conjunction with this report in considering the results of our audit.

The management's discussion and analysis (located on pages 14 through 19) and historical pension information (located on pages 31 through 32) are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the WRS's basic financial statements. The supplementary information, introductory section, investment section, actuarial section, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory, investment, actuarial and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

A handwritten signature in cursive script that reads "Sullivan, King & Company, LLC".

May 23, 2006

Management's Discussion & Analysis

Our discussion and analysis of the Worcester Retirement System's (WRS) financial performance provides an overview of the WRS's financial activities for the fiscal year ended December 31, 2005. Please read it in conjunction with the transmittal letter in the Introductory Section, at the front of this report, and the basic financial statements that follow this discussion. The Management's Discussion and Analysis (MD&A) is intended to serve as an introduction to the WRS's basic financial statements, as well as to offer readers of the WRS's financial statements a narrative view and analysis of the WRS's financial activities.

Financial Highlights

The WRS's funding objective is to meet long-term benefit obligations through contributions and investment income. As of December 31, 2005, the funded ratio was 79.81% based on the market value of assets at that date.

Net assets increased during the year by \$37.9 million, or 6.3%, because of strong investment returns. Net assets are the residual of the WRS's assets in excess of the WRS's liabilities as of the statement date. The WRS's assets are held in trust to meet future benefit payments.

Total investment gains were \$55.5 million. The investment rate of return was 9.7% compared with a positive return of 12.1% in the previous year (refer to the "Investment Results" table in the Investment Section).

Overview of the Financial Statements

The basic financial statements are comprised of a Statement of Plan Net Assets, Statement of Changes in Plan Net Assets, Notes to the Financial Statements and Required Supplementary Information.

The *Statement of Plan Net Assets* presents information on the WRS's assets and liabilities and the resulting net assets held in trust for pension benefits. This is calculated using the following formula: Assets – Liabilities = Net Assets held in trust for pension benefits. This statement reflects the WRS's investments at fair value, as well as cash, receivables and other assets and liabilities. The Statement of Plan Net Assets reports the financial position of the WRS at December 31, 2005. Over time, the increase or decrease in net assets serves as a useful indicator of the WRS's financial health.

The *Statement of Changes in Plan Net Assets* presents information showing how the WRS's net assets held in trust for pension benefits changed during the year ended December 31, 2005. It reflects contributions by members and participating employers along with deductions for retirement benefits, refunds, and withdrawals, and administrative expenses. Investment income during the period is also presented showing income from investing and securities lending activities.

Management's Discussion & Analysis

The *Notes to the Financial Statements* provide additional information that is essential for the reader to gain a full understanding of the data provided in the financial statements.

The *Required Supplementary Information* includes this MD&A and schedules of funding progress and employers' contributions.

Financial Analysis

The WRS's total assets as of December 31, 2005 were \$658.9 million and were primarily comprised of cash and cash equivalents, receivables, and investments. Total assets increased \$30.9 million, or 4.9%, from the prior year primarily due to investment gains.

Total liabilities as of December 31, 2005 were \$14.8 million and were primarily comprised of payables for securities purchased as well as payables to other state retirement plans and collateral held under securities lending arrangements. Total liabilities decreased by \$7.1 million, or 32.4%, over the period.

The following tables present current and prior year data on the WRS's financial statements.

Management's Discussion & Analysis

Net Assets

Net assets of the WRS totaled \$644.0 million at the close of the fiscal year and are summarized as follows:

Plan Net Assets (In thousands of dollars)

Assets	2005	2004
Cash	\$ 8,758	10,057
Investments	634,689	595,736
Securities lending short-term collateral investment pool	8,555	18,860
Receivables:		
Interest due and accrued	3,776	1,259
Due from Commonwealth of Massachusetts and other systems	350	2,039
Receivable for securities sold	2,088	-
Other	648	83
	<u>658,864</u>	<u>628,034</u>
Total assets	658,864	628,034
Liabilities		
Accounts payable and accrued expenses	673	555
Due to Commonwealth of Massachusetts and other systems	2,209	1,849
Payable for securities purchased	3,411	670
Collateral held on securities lending transactions	8,555	18,860
	<u>14,848</u>	<u>21,934</u>
Total liabilities	14,848	21,934
Net assets held in trust for pension benefits	\$ <u>644,016</u>	<u>606,100</u>

Management's Discussion & Analysis

Changes in Net Assets

The WRS's total net assets increased by \$37.9 million during the current fiscal year and are summarized as follows:

Changes in Net Assets

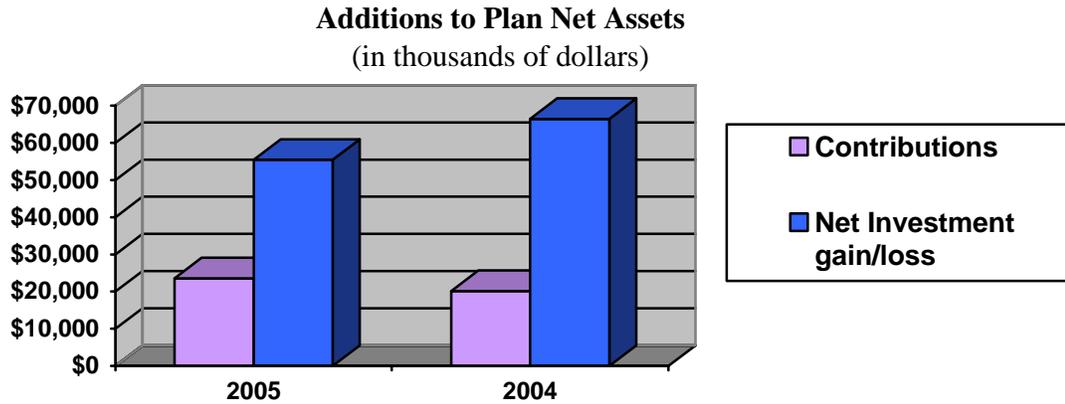
(in thousands of dollars)

	2005	2004
Additions		
Contributions:		
Employers	\$ 23,580	20,150
Plan members	12,510	12,187
Reimbursements from Commonwealth of Massachusetts	2,665	3,141
Reimbursements from other Systems	350	390
Net investment income:		
Interest and dividends	13,214	9,861
Securities lending income	510	296
Net realized and unrealized gains (losses)	45,725	60,029
Less: management fees	(3,506)	(3,457)
Less: borrower rebates & fees	(472)	(274)
Total additions	94,576	102,323
Deductions		
Benefits payments to plan members and beneficiaries	52,106	50,517
Reimbursements to other systems	2,212	1,873
Refunds and transfers of plan member accounts to other systems	1,785	1,832
Administrative expenses	557	518
Total deductions	56,660	54,740
Change in plan net assets	37,916	47,583
Net assets held in trust for pension benefits:		
Beginning of year	606,100	558,517
End of year	\$ 644,016	606,100

Management’s Discussion & Analysis

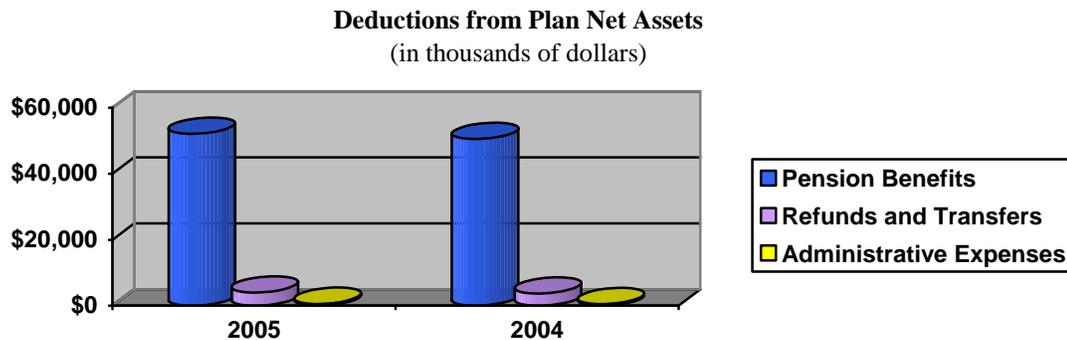
Additions to Plan Net Assets

The amount needed to finance benefits is accumulated through the collection of employers’ and employees’ contributions, reimbursements from the Commonwealth of Massachusetts for pre-1998 COLA’s and through earnings on investments. Contributions and net investment gain for calendar year 2005 resulted in total additions to net assets of \$94.6 million. Employers’ contributions increased by \$3.4 million in 2005. The WRS had a net investment gain of \$55.5 million in 2005 versus a gain of \$66.5 million in 2004.



Deductions from Plan Net Assets

The primary deductions of the WRS include the payment of pension benefits to participants and beneficiaries, refunds of contributions, and the costs of administering the WRS. Total deductions from net assets for 2005 were \$56.7 million, which represents an increase of 3.7% over deductions of \$54.7 million in 2004. The payment of pension benefits increased by \$1.6 million, or 3.2%, over the previous year. The increase in these expenses resulted from an increase in benefit payments to newer retirees with higher average compensation offset by a small decrease in the number of pensioners and beneficiaries (2,967 in 2004 versus 2,919 in 2005).



Management's Discussion & Analysis

Overall Financial Position of WRS

Due to a continuous improvement in the financial markets, the WRS has experienced an increase in its investment portfolio for the fiscal year ending December 31, 2005. Management believes the WRS is in a solid financial position and will be able to meet its obligations.

Contacting WRS's Financial Management

This financial report is designed to provide the Board, our membership, taxpayers, investors, and creditors with a general overview of the WRS's financial results and to demonstrate WRS's accountability for the funding it receives. If you have any questions about this report or need additional financial information, contact the Worcester Retirement System, City Hall Room 103, 455 Main Street, Worcester, Massachusetts 01608.

WORCESTER RETIREMENT SYSTEM
 (A Component Unit of the City of Worcester, Massachusetts)
Statement of Plan Net Assets
 December 31, 2005

Assets	
Cash & Cash Equivalents	\$ <u>8,758,160</u>
Investments:	
Equities	254,508,485
Fixed Income	98,261,521
Pooled Equities	115,022,851
Pooled Fixed Income	44,569,198
Real Estate	80,211,050
Alternative Investments	<u>42,115,917</u>
Total investments	<u>634,689,022</u>
Securities lending short-term collateral investment pool	<u>8,554,774</u>
Receivables:	
Accrued interest and dividends	3,775,893
Due from Commonwealth of Massachusetts and other systems	350,242
Receivable for securities sold	2,087,806
Other receivables	<u>648,349</u>
Total receivables	<u>6,862,290</u>
Total plan assets	<u>658,864,246</u>
Liabilities	
Accounts payable and accrued expenses	673,096
Due to Commonwealth of Massachusetts and other systems	2,209,249
Payable for securities purchased	3,410,623
Collateral held on securities lending transactions	<u>8,554,774</u>
Total plan liabilities	<u>14,847,742</u>
Net assets held in trust for pension benefits (see schedule of funding progress on page 31)	\$ <u><u>644,016,504</u></u>

See accompanying notes to financial statements.

WORCESTER RETIREMENT SYSTEM
(A Component Unit of the City of Worcester, Massachusetts)
Statement of Changes in Plan Net Assets
Year ended December 31, 2005

Additions:

Contributions:	
Employers	\$ 23,579,478
Plan members	12,509,613
Reimbursements from Commonwealth of Massachusetts	2,665,402
Reimbursements from other systems	<u>350,243</u>
 Total contributions	 <u>39,104,736</u>
Investment income (loss):	
Interest and dividends	13,213,671
Securities lending income	510,165
Net realized and unrealized gains	45,725,444
Less: management fees	(3,506,187)
Less: borrower rebates and fees under securities lending program	<u>(472,314)</u>
 Net investment income	 <u>55,470,779</u>
 Total additions	 <u>94,575,515</u>

Deductions:

Benefit payments to plan members and beneficiaries	52,105,583
Reimbursements to other systems	2,211,530
Refunds and transfers of plan member accounts to other systems	1,784,733
Administrative expenses	<u>556,781</u>
 Total deductions	 <u>56,658,627</u>
 Change in plan net assets	 37,916,888

Net assets held in trust for pension benefits:

Beginning of year	<u>606,099,616</u>
 End of year	 <u><u>\$ 644,016,504</u></u>

See accompanying notes to financial statements.

**Notes to Financial Statements
December 31, 2005**

1. Summary of Significant Accounting Policies

(a) Financial Reporting Entity

Because of the significance of its operational and financial relationship with the City of Worcester, Massachusetts (City), the Worcester Retirement System (WRS) is included as a blended component unit in the City's financial statements.

(b) Basis of Accounting

The accompanying financial statements are presented on the accrual basis of accounting.

(c) Revenue Recognition

Contributions are recognized as additions in the period when they become due pursuant to formal commitments, statutory or contractual requirements. Investment income is recognized when earned.

(d) Benefits and Refunds

Benefits and refunds to WRS members and beneficiaries are recognized as deductions when due and payable in accordance with the terms of the WRS.

(e) Cash and Investments

Cash is considered to be cash on hand, demand deposits and short-term investments with an original maturity of three months or less from the date of acquisition.

Investments are reported at fair value. Fair values of investments are based on quotations from a national securities exchange except for pooled funds, venture capital and real estate, for which fair values are estimated as detailed below.

Pooled Funds

The fair value of shares in managed investment pools is based on unit values reported by the funds.

Venture Capital

Venture capital investments are recorded at fair value as determined in good faith by the general partners of the venture capital firms after consideration of pertinent information, including current financial position and operating results, price-earnings multiples and available market prices of similar companies' securities, the nature of securities, marketability, restrictions on disposition and other appropriation and do not necessarily represent amounts which might ultimately be realized, since such amounts depend on future circumstances and cannot reasonably be determined until individual securities are liquidated.

Real Estate

The fair value of real estate funds is based on independent third-party appraisals. The investment managers of the funds are responsible for the reported value of those investments. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the real estate existed, and the differences could be material.

(f) Basis of Investment Transactions

Purchases and sales of investments are recorded on the trade date. Transactions remaining unsettled as of year-end are recorded as payables for securities purchased and as a receivable for securities sold.

(g) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Fair values of real estate funds and venture capital funds have been estimated in the absence of readily available market values, and these estimates may be materially different than values that would have been used had a ready market existed.

(h) Administrative Expenses

Administrative expenses are financed by investment income.

2. Plan Description

(a) General

The WRS is a cost-sharing multiple-employer public employee retirement system established by the City on June 12, 1944, under Massachusetts General Laws (MGL), Chapter 32, and is regulated by the Massachusetts Public Employee Retirement Administration Commission (PERAC). The WRS is a defined benefit pension plan that covers certain eligible employees of the City and the Worcester Housing Authority.

Membership in the WRS is mandatory immediately upon the commencement of employment for all permanent full-time employees working at least 20 hours weekly, except for City schoolteachers, who participate in the Massachusetts Teachers' Retirement System.

Membership in the WRS was as follows at December 31, 2005:

Active employees	3,430
Pensioners and beneficiaries	2,919
Inactive employees	<u>1,007</u>
Total members	<u>7,356</u>
Number of participating employers	<u>2</u>

The WRS is administered by a five-person Retirement Board (the Board) consisting of the City Auditor, who serves *ex-officio*; two members who are elected by the participants in or retired from the service of the WRS; a fourth member appointed by the City Manager; and a fifth member appointed by the other members.

(b) Significant Plan Provisions and Requirements

Benefit provisions and state law establishes contribution requirements of the WRS. Members of the WRS become vested after 10 years of creditable service. Normal retirement occurs at age 65 except for employees of the City's Police and Fire departments, whose normal retirement age is 55. Retired employees receive an allowance based upon the average of their three highest average salary years of service multiplied by (1) the number of years and full months of creditable service at the time of retirement and (2) a percentage based on age at retirement in accordance with a schedule provided by state law.

Assuming normal retirement at age 65, this percentage is 2.5%, which is reduced for individuals who retire prior to age 65 to reflect the longer pay out period.

Employees may elect early retirement after 20 years of service or at any time after attaining age 55 with 10 years of eligible service. Plan members who become permanently and totally disabled may be eligible to receive a disability retirement allowance. The amount of benefits to be received depends on several factors, including the member's age, compensation, veteran status, years of service and whether or not the disability is work-related. In addition, certain death benefits exist for beneficiaries of employees who die in active service.

Under MGL, c.32 Section 3(8)(c), the WRS is reimbursed for benefits paid to eligible participants with previous service in other Chapter 32 plans. Conversely, the WRS is obligated to pay a proportionate share of benefits for participants entitled to benefits for subsequent participation in other Massachusetts Municipal plans.

Also under MGL c.32, for members leaving the City's employment to work for other Massachusetts governmental units, the WRS transfers their accumulated account balances and creditable service to the retirement system of their new employer. Other such retirement systems are in turn required to make comparable transfers to the WRS for employees coming to work for the City or the Worcester Housing Authority.

3. Deposits and Investments

Deposits and investments made by the WRS are governed by the MGL c.32. The WRS has the ability to invest in equity securities, corporate bonds, annuities and other specified investments in accordance with state laws and regulations.

Deposits - Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of a bank failure, the WRS's deposits may not be recovered. The WRS's policy for custodial credit risk of deposits is to rely on FDIC insurance coverage for the first \$100,000 of deposits held at each financial institution. As of December 31, 2005, \$567,545 of the WRS's bank balance of \$736,084 was uninsured and uncollateralized.

Investments Summary

The WRS's investments at December 31, 2005 are presented below. All investments are presented by investment type, with debt securities presented by maturity.

Worcester Retirement System

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 - 5	6 - 10	More Than 10
<u>Debt Securities:</u>					
U.S. Treasuries.....	\$ 36,222,065	-	10,436,251	15,050,604	10,735,210
U.S. Agencies.....	19,585,094	-	4,014,914	1,822,119	13,748,061
Corporate bonds.....	37,866,513	636,623	7,910,621	13,287,957	16,031,312
Money market mutual funds..	17,120,913	17,120,913	-	-	-
Debt security mutual funds....	49,157,047	49,157,047	-	-	-
Total debt securities.....	<u>159,951,632</u>	<u>66,914,583</u>	<u>22,361,786</u>	<u>30,160,680</u>	<u>40,514,583</u>
<u>Other Investments:</u>					
Equity securities.....	139,770,810				
Equity mutual funds.....	229,760,526				
Real estate investments.....	80,211,050				
Alternative investments.....	<u>42,115,917</u>				
Total other investments.....	<u>491,858,303</u>				
Total investments.....	<u>\$ 651,809,935</u>				

Investments - Interest Rate Risk of Debt Securities

Interest rate risk for debt securities is the risk that changes in interest rates of debt securities will adversely affect the fair value of an investment. The WRS's policies for interest rate risk intend that the average duration of investments remain fairly stable over time and be focused in the intermediate range. The WRS's debt security managers are not permitted to make large-scale changes in portfolio duration in an attempt to anticipate interest rate changes. However, they are permitted to shift portfolio duration within a limited range (defined by their guidelines) in an effort to enhance performance.

Investments - Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty, the WRS will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The WRS's policy for custodial credit risk of investments intends that all investments are either insured and/or registered in the name of the WRS. As of December 31, 2005, the WRS was not exposed to custodial credit risk.

Investments - Credit Risk of Debt Securities

Credit risk for debt securities is the risk that an issuer or other counterparty to a debt security will not fulfill its obligations. The WRS's policies for credit risk of debt securities sets minimum average quality requirements for investment strategies employed, among other limitations. In monitoring credit risk, the WRS relies on credit ratings assigned by Moody's and Standard & Poor's. As of December 31, 2005, the credit quality ratings of the WRS's debt securities are as follows:

Quality Ratings *	Investment Type			Fair Value
	Corporate Bonds	Money Market Mutual Funds	Debt Security Mutual Funds	
AAA.....	\$ 2,698,557	-	2,491,336	5,189,893
AA+.....	240,842	-	-	240,842
AA.....	356,391	-	-	356,391
AA-.....	190,904	-	-	190,904
A+.....	721,575	-	-	721,575
A.....	2,208,848	-	-	2,208,848
A-.....	1,017,210	-	-	1,017,210
BBB+.....	677,215	-	-	677,215
BBB.....	3,364,490	-	-	3,364,490
BBB-.....	3,238,837	-	-	3,238,837
BB+.....	2,053,201	-	-	2,053,201
BB.....	3,383,307	-	-	3,383,307
BB-.....	3,437,585	-	-	3,437,585
B+.....	2,516,938	-	-	2,516,938
B.....	3,145,480	-	-	3,145,480
B-.....	2,373,663	-	-	2,373,663
CCC+.....	469,627	-	-	469,627
CCC.....	797,125	-	-	797,125
CCC-.....	203,857	-	-	203,857
D.....	322,813	-	-	322,813
Unrated.....	4,448,048	17,120,913	46,665,711	68,234,672
Total.....	\$ <u>37,866,513</u>	<u>17,120,913</u>	<u>49,157,047</u>	<u>104,144,473</u>

* Per the rating scale of Standard & Poors, a national credit rating organization

Deposits and Investments – Foreign Currency Risk

Foreign currency risk is the risk that fluctuations in exchange rates will adversely affect the fair value of an investment or a deposit. The WRS's policy is to limit investments in non-U.S. dollar-denominated securities to not exceed 10% of the total market value of investments at all times. As of December 31, 2005, the WRS's exposure to foreign currency risk is as follows:

Deposit/Investment Type	U.S. Dollar Balances	Currency
U.S. Agencies.....	\$ 1,391,429	Mexican peso
U.S. Agencies.....	641,838	Singapore dollar
Corporate bonds.....	585,077	Singapore dollar
Corporate bonds.....	494,295	British pound sterling
Corporate bonds.....	479,159	Thailand baht
Corporate bonds.....	369,627	Brazilian real
U.S. Agencies.....	322,181	Argentine peso
Corporate bonds.....	156,956	New Zealand dollar
Corporate bonds.....	85,659	Canadian dollar
Corporate bonds.....	42,710	Indonesian rupiah
U.S. Agencies.....	37,116	Colombian peso
Total.....	\$ 4,606,047	

Investments – Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the WRS's investment in a single issuer. The WRS's policy for concentration of credit risk instructs investment managers not to invest more than 5% of their portfolio at market value in a single security, or in the securities of a single issuer or its subsidiaries. U.S. Treasury, U.S. government agency, mutual fund and pooled fund investments are exempted from this restriction. As of December 31, 2005, the WRS was not exposed to concentration of credit risk.

4. Securities Lending Transactions

PERAC has issued supplemental regulations that permit the WRS to engage in securities lending transactions. These transactions are conducted by the WRS's custodian, who lends certain securities owned by the WRS to other broker-dealers and banks pursuant to a form of loan agreement. The WRS and the borrowers maintain the right to terminate all securities lending transaction on demand.

The custodian lends, at the direction of the lending agent, the WRS's securities and cash received (including both U.S. and foreign currency), U.S. government securities, sovereign debt of foreign countries, and irrevocable bank letters of credit as collateral. The custodian does not have the ability to pledge or sell collateral unless the borrower defaults. Borrowers are required to deliver cash collateral in amounts equal to not less than 105% of the market value of foreign securities on loan and 102% of the market value of domestic securities on loan (Required Collateral Level). If at any time the market value of the collateral for any loan decreases to 100% or less of the market value of the loaned securities, borrowers are required to provide additional collateral sufficient to increase the market value of the collateral to at least the Required Collateral Level.

The WRS does not impose any restrictions on the amount of securities lent on its behalf by the custodian. There were no failures by any borrowers to return loaned securities or pay distributions thereon, nor were there any losses from default of the borrowers or the custodian for the year ended December 31, 2005. The cash collateral received on each loan was invested; together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. The relationship between the average maturities of the investment pool and loans was affected by the maturities of the loans made by other plans that invested cash collateral in the collective investment pool, which the WRS could not determine. At December 31, 2005, the WRS had no credit risk exposure to borrowers because the amounts the WRS owed the borrowers exceeded the amounts owed the WRS. The cash collateral held and the fair value of the securities on loan for the WRS at December 31, 2005 and 2004 was \$8,554,774 and \$8,517,444, and \$18,859,680 and \$18,814,108, respectively. Borrower rebates and fees paid to the broker were \$472,314 for the year ended December 31, 2005.

5. Funding Policy

Depending on their employment date, active System members must contribute 5%, 7%, 8% or 9% of their gross regular compensation. Members hired after December 31, 1978 must contribute an additional 2% of regular compensation in excess of \$30,000. These deductions earn interest at a rate determined by PERAC that vests based upon years of service. Administrative costs are financed from investment income.

Except for a portion of benefits owed due to cost-of-living adjustments granted through June 30, 1998, member employers are required to contribute the remaining amounts necessary to finance benefits. Member employer contributions are determined by the annual actuarial valuation.

COLA's granted through June 30, 1998 are reimbursed by the Commonwealth of Massachusetts (the Commonwealth). COLA's granted subsequent to June 30, 1998 must be granted by the Board and are the responsibility of the WRS. The WRS has granted the maximum increase every year since June 30, 1998.

6. Legally Required Reserve Accounts

The balances in the WRS' legally required reserves as of December 31, 2005 are as follows:

<u>Description</u>	<u>Amount</u>	<u>Purpose</u>
Annuity Savings Fund	\$ 130,292,925	Active members' contribution balance
Annuity Reserve Fund	48,729,409	Retired members' contribution account
Military Service Fund	17,039	Members' contribution account while on military leave
Pension Reserve Fund	363,394,044	Amounts appropriated to fund future retirement
Pension Fund	<u>101,583,087</u>	Remaining net assets
 Total	 \$ <u><u>644,016,504</u></u>	

All reserve accounts are funded at levels required by state law.

Required Supplementary Information

The following reflects the Schedule of Funding Progress under the Entry-Age-Normal Actuarial Cost Method, which is the required method for all retirement systems governed by MGL, c.32. The WRS believes that this method of valuation more clearly reflects the actual funding status of the WRS.

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (b - a)	Funded Ratio (%) (a/b)	Covered Payroll (c)	UAAL as a Percent of Covered Payroll (b - a)/c
1/1/2001	\$ 630,714,618	628,681,483	(2,033,135)	100.32	\$ 136,000,517	(1.49)
1/1/2002	620,814,307	671,876,943	51,062,636	92.40	148,764,543	34.32
1/1/2003	554,190,090	715,855,564	161,665,474	77.42	142,802,508	113.21
1/1/2004	577,123,067	743,570,440	166,447,373	77.62	138,796,895	119.92
1/1/2005	606,099,616	771,948,311	165,848,695	78.52	147,126,606	112.73
1/1/2006	644,016,504	806,957,464	162,940,960	79.81	145,830,593	111.73

Schedule of Employer Contributions

Year Ended <u>December 31</u>	Annual Required <u>Contributions</u>	Percentage of Annual <u>Required Contributed (%)</u>
2000	\$ 8,280,410	100
2001	9,480,000	100
2002	12,956,778	100
2003	18,928,252	100
2004	20,150,377	100
2005	23,579,478	106

**Notes to Required Supplementary Information
December 31, 2005**

Valuation Date	January 1, 2006
Actuarial cost method	Entry Age Normal Cost Method
Amortization method	Payments increase 1.50% per year on the 2002 ERI liability, level payments on the 2003 ERI liability and the Section 90 ACD liability, and 4.50% on the remaining unfunded liability
Remaining amortized period	The remaining effective amortization period is 17 years and the period is closed
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return	8.25%
Projected salary increases	5.00%
Rate of inflation	4.00%
Cost of living adjustments	3.00% for the first \$12,000 of retirement income

Supplementary Information**Schedule of Administrative Expenses**

The composition of administrative expenses for the year ended December 31, 2005 is as follows:

Personal Services:	
Staff Salaries	\$ 299,228
Board Member Compensation	15,000
Insurance	<u>33,320</u>
Total Personal Services	<u>347,548</u>
Professional Services:	
Legal Expenses	90,781
Actuarial Fees	23,500
Audit Fees	20,000
Computer Consultant Fees	2,288
Medical Fees	<u>201</u>
Total Professional Services	<u>136,770</u>
Miscellaneous:	
Travel	11,756
Printing	2,483
Other	<u>58,224</u>
Total Miscellaneous	<u>72,463</u>
Total Administrative Expenses	<u><u>\$ 556,781</u></u>

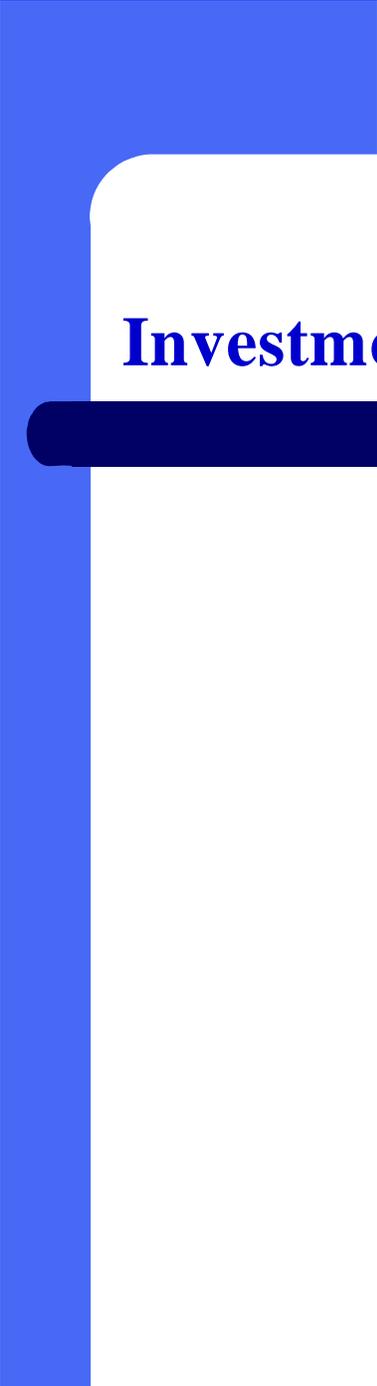
Schedule of Investment and Consultants' Expenses

Investment Expenses:

Management Fees:	
Domestic & Equity Managers	\$ 1,114,662
Venture Capital Funds	677,215
Domestic Fixed Income Managers	278,807
International Investments Managers	446,483
Real Estate Investments Managers	594,974
Investment Fees	121,000
Custodial Fees	<u>273,046</u>
Total Management Fees	<u>3,506,187</u>
Securities Lending Fees:	
Borrowers Rebates	455,949
Fees	<u>16,365</u>
Total Securities Lending Fees	<u>472,314</u>
Total Investment Expenses	<u><u>\$ 3,978,501</u></u>

Consultant Expenses:

Independent Audit Fees	\$ 20,000
Actuarial Fees	23,500
Legal Fees	<u>90,781</u>
Total Consultant Expenses	<u><u>\$ 134,281</u></u>



Investment Section



REPORT ON INVESTMENT ACTIVITY

The information contained in the Investment Section of the Comprehensive Annual Financial Report (CAFR) has been prepared by Meketa Investment Group, acting as the investment consultant for the Worcester Retirement System (WRS). All investment information herein has been reconciled between the WRS, the investment managers hired by the WRS, and Meketa Investment Group. The investment returns presented herein were calculated using a time-weighted rate of return methodology based upon market values.

OUTLINE OF INVESTMENT POLICIES

The purpose of this section is to set forth the goals and objectives of the WRS, and to establish guidelines for the implementation of investment strategy.

The Board of the WRS recognizes that a stable, well-articulated investment policy is crucial to the long-term success of the WRS. As such, the Board has developed this Investment Policy Statement with the following goals in mind:

- To clearly and explicitly establish the objectives and constraints that govern the investment of the WRS's assets,
- To establish a long-term target asset allocation with a high likelihood of meeting the WRS's objectives given the explicit constraints, and
- To protect the financial health of the WRS through the implementation of this stable long-term investment policy.

I. Worcester Retirement System Goals

The WRS was established to provide retirement income for the City of Worcester and WHA employees and their beneficiaries. The WRS's assets are structured to provide real growth from capital gains and income, while maintaining sufficient liquidity to meet the WRS's benefit payments.

II. Investment Objectives

The investment strategy of the WRS is designed to ensure the prudent investment of funds in such a manner as to provide real growth of assets over time while protecting the value of the assets from undue volatility or risk of loss.

Risk Objectives

- To accept a level of market risk consistent with moderate interim volatility without sacrificing the potential for long-term real growth of assets.
- To use extensive diversification to minimize or eliminate completely exposure to company and industry-specific risks in the aggregate investment portfolio.
- To avoid extreme levels of volatility that could adversely affect WRS's portfolio.

- To limit the likelihood of investment return patterns that could negatively impact the funded status of the WRS.

Return objective

- Within the risk constraints outlined above, to achieve the highest real return possible.
- To achieve, over long time periods, investment returns consistent with the actuarial return on assets of 8.25%.

III. Investment Constraints

Legal and Regulatory

The WRS is a qualified defined benefit pension plan governed by the Massachusetts General Laws, Chapter 32. Investment procedures and restrictions stipulated under these regulations must be followed.

The Board intends to manage the assets of the WRS at all times in accordance with the provisions of the Public Employee Retirement Administration Commission (PERAC) and the Massachusetts General Laws, Chapter 32. The Board will retain legal counsel when appropriate to review contracts and provide advice with respect to applicable statutes and regulations.

Time Horizon

The WRS will be managed on a going-concern basis. The assets of the WRS will be invested with long-term time horizon (twenty years or more), consistent with the participant demographics and the purpose of the WRS.

Liquidity

The WRS exhibits a moderate need for interim liquidity. Cash outflows for benefit payments are expected to grow from approximately \$52.1 million to close to \$77 million over the next ten years, while cash flows are expected to rise from approximately \$39.1 million to \$49.2 million (covering normal costs and expenses) over the same period. This pattern results in a net negative cash flow of up to 4% of WRS assets, based on the WRS's year-end asset value and the actuarial assumed rate of return of 8.25% per year.

Tax Considerations

The WRS is a tax-exempt entity. Therefore, investments and strategies will be evaluated only on the basis of expected risks and potential returns.

IV. Risk and Return Considerations

The WRS's Board recognizes that a persistent positive relationship exists between risk and return, whether risk is described as possibility of loss or as interim volatility. The Board also recognizes that investors are rarely compensated for risks that can be eliminated through diversification. Within the risk and return parameters discussed above, the Board accepts the risks associated with investing in the capital markets (market risks), but will minimize wherever possible those risks for which the WRS is unlikely to be compensated (non-market or diversifiable risks).

V. Diversification

The WRS's Board recognizes that a primary element of risk control is diversification. Therefore, investments will be allocated across multiple classes of assets, chosen in part for their low correlation of returns. Within each asset type, investments will be distributed across many individual holdings, thus further reducing volatility. In addition, each investment manager's guidelines will specify the largest permissible investment in any one asset, and the largest permissible investment in any group of related assets.

The WRS's aggregate equity portfolio will be diversified by individual issue, capitalization, and industry (international equity portfolios will also be diversified by country). The WRS's aggregate fixed income portfolio will, at a minimum, be diversified by individual issue, by issuer, by maturity, and by industry. Residual cash will be swept by the custody bank into a short-term fixed income investment pool that is broadly diversified across individual issue and issuer. The WRS's aggregate real estate portfolio will be invested across a spectrum of geographic regions and property types.

The specific degrees of diversification within the above asset classes will be addressed in each manager's investment guidelines.

VI. Asset Allocation

The Board recognizes that the allocation of monies to various asset classes will be the major determinant of the WRS return and risk experience over time. Therefore, the WRS will allocate investments across those asset classes that, based on historical and expected returns and risks, provide the highest likelihood of meeting the WRS's investment objectives.

A. Permissible Asset Classes

Because investment in any particular asset class may or may not be consistent with the objectives of the WRS, the Board has specifically indicated those asset classes that may be utilized when investing the WRS's assets, and are summarized as follows:

Asset Type	Asset Class	Purpose
Equity	U.S. Common Stocks	Total Return Potential
Equity	Non-U.S. Common Stocks	Total Return Potential Diversification
Equity	Private Markets	Total Return Potential Diversification
Fixed Income	High Grade Bonds	Return Stability Income
Fixed Income	High Yield Bonds	Total Return Potential Diversification Income
Fixed Income	Bank Loans	Total Return Potential Diversification Income
Real Estate	Real Estate	Total Return Potential Diversification Income
Timber	Timber	Total Return Potential Diversification
Hedge Funds	Absolute Return Strategies	Return Stability Diversification
Cash	Cash Equivalents	Liquidity Return Stability

B. Expected Returns, Risks, and Correlations for Permissible Asset Classes

The risk and return behavior of the WRS will be driven primarily by the allocation of investments across asset classes. In determining the appropriate allocation, the expected return and risk behavior of each asset class and the likely interaction of various asset classes in a portfolio must be examined.

C. Long-Term Target Allocations

Based on the investment objectives and constraints of the WRS, and on the expected behavior of the permissible asset classes, the Board will specify a long-term target allocation for each class of permissible assets. These targets will be expressed as a percentage of the WRS's overall market value, surrounded by a band of permissible variation resulting from market forces.

The long-term target allocations are intended as strategic goals, not short-term imperatives. Thus, it is permissible for the overall System's asset allocation to deviate from the long-term target, as would likely occur during manager transitions, asset class restructurings, and other temporary changes in the WRS. Deviations from targets that occur due to capital market changes are discussed below:

ASSET ALLOCATION TARGETS

	Target (%)	Range (%)
Equity	55	47-63
Domestic Equity: Large Cap	27	22-32
Domestic Equity: Small Cap	8	6-10
Non-U.S. Common Stocks	20	17-23
Fixed Income	21	16-26
Investment Grade (excl. TIPS)	8	5-11
TIPS	5	3-7
High Yield	5	3-7
Bank Loans	3	2-4
Real Estate¹	10	8-12
Timber	3	2-4
Private Equity	6	4-8
Absolute Return	5	3-7
Cash²	0	0-5

¹ WRS is restricted by PERAC to target allocations of 10% for real estate, and 5% for private equity. WRS will make reasonable attempts to maintain those allocations, recognizing that market fluctuations and the funding requirements of alternative investments may result in short-term deviations from the targets. The Real Estate target includes a strategic allocation to Timber of 3%.

² The cash target of zero defines WRS's objective of keeping cash balances as low as possible, at least below 5% at all times. The Board is aware, however, that a certain cash balance is needed for the efficient operation of WRS and its various portfolios.

Based upon the expected asset returns, risks, and correlations determined by Meketa Investment Group, this target allocation exhibits an expected annual return of 8.6% and an expected annual standard deviation of 13%.

D. Rebalancing

In general, cash flows to and from the WRS will be allocated in such a manner as to move each asset class toward its target allocation.

The Board recognizes that, periodically, market forces may move the WRS's allocations outside the target ranges. The Board also recognizes that failing to rebalance the allocations would unintentionally change the WRS's structure and risk posture. However, the Board understands that constant rebalancing would result in a significant increase in explicit and implicit trading costs to the WRS. Consequently, the Board has established a process to rebalance the allocations periodically.

On at least an annual basis, if any strategic allocation is outside the specified target range, assets will be shifted to return the strategy to the target range. The specific plan for rebalancing will identify those assets that can be shifted at the lowest possible risk and cost, if the rebalancing cannot be accomplished solely by allocating contributions and withdrawals.

E. Changes to Asset Allocation

Once established, permanent changes in the WRS's target asset allocation will take place only in response to significant changes in the objectives and constraints of the WRS, or in response to material changes in the fundamental nature or appropriateness of the asset classes themselves.

VII. Review of Investment Policy, Asset Allocation, and Performance

The Investment Policy Statement will be reviewed at least annually, and specifically upon each actuarial valuation, to ensure that the objectives and constraints remain relevant. However, the Board recognizes the need for a stable long-term policy for the WRS, and major changes to this policy statement will be made only when significant developments in the circumstances of the WRS occur. The Board will notify PERAC of any changes to this document within ten days of the effective date of those changes.

The asset allocation of the WRS will be reviewed on an on-going basis, and at least annually. When necessary, such reviews may result in a rebalancing of asset allocations. In general, the Board intends that the WRS will adhere to its long-term target allocations, and that major changes to these targets will be made rarely and only in response to significant developments in the circumstances of the WRS.

The Board will specifically evaluate the performance of the WRS relative to its objectives and to the returns available from the capital markets during the period under review. In general, the Board will utilize relative, rather than absolute, benchmarks in evaluating performance.

VIII. Trading and Proxy Voting by Investment Managers

In accordance with the fiduciary and other obligations imposed on investment managers by their agreements with the Board, all trades executed by managers must be for the exclusive benefit of the WRS's participants and beneficiaries. Managers are expected to seek best execution on all trades. This is addressed in the individual manager guidelines.

The Board recognizes that the right to vote proxies for securities held represents an asset of the WRS.

As such, the Board has specifically delegated the responsibility for voting all security proxies to the individual managers. The Board believes that the voting of proxies constitutes an investment decision by the managers, and that prudent voting of proxies is important to the overall performance of the WRS. Investment managers are expected to execute all proxy votes in a timely fashion and to provide a full written accounting of proxy votes on an annual basis.

IX. Management Structure

To diversify the WRS's assets so as to minimize the risk associated with dependence on the success of one enterprise, the Board Members have decided to employ a multi-manager team approach to investing System assets.

A consultant will be employed whose responsibilities will be to: 1) provide risk and return assumptions for various asset classes, 2) to diversify WRS so as to minimize risk, while enhancing the probability of achieving the WRS's return objectives, and 3) to evaluate the performance and compliance of investment managers.

Investment managers will be employed to utilize individual expertise within their assigned area of responsibility. Each manager will be governed by individual investment guidelines.

X. Implementation

All monies invested for the WRS after the adoption of this investment policy statement shall conform to this statement.

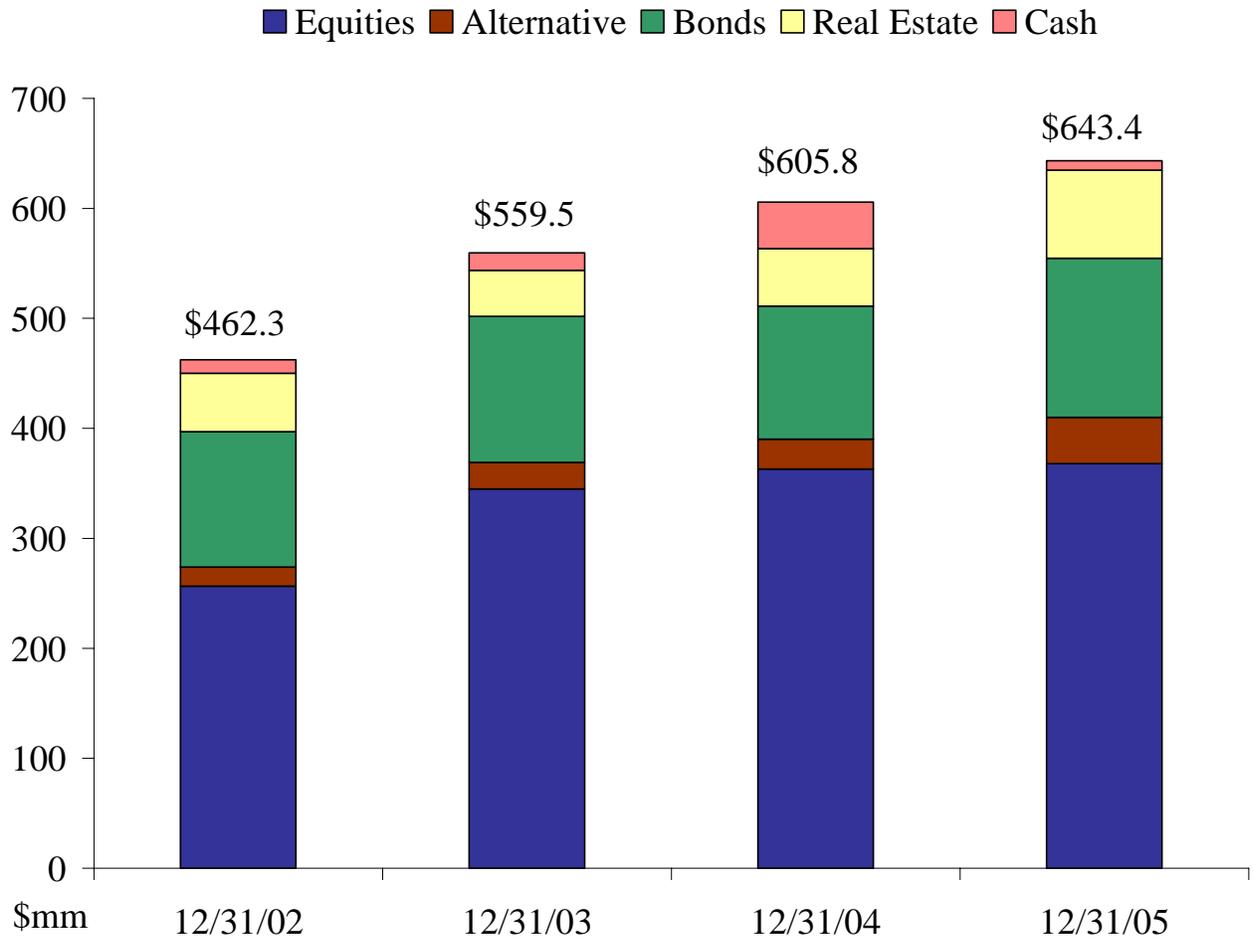
Investment Results*

	4Q05	1 YR	3 YR	5 YR
Total Portfolio	2.4	9.7	15.5	5.0
CPI (Inflation)	(1.0)	3.4	2.8	2.5
Total Equity	3.1	11.8	20.9	4.2
Russell 3000	2.0	6.1	15.9	1.6
S&P 500	2.1	4.9	14.4	0.5
MSCI EAFE	4.1	13.5	23.7	4.6
Total Fixed Income	0.6	3.1	7.1	7.1
Lehman Universal	0.6	2.7	4.5	6.3
Total Real Estate	4.4	25.2	12.7	9.0
NCREIF Property	4.4	19.1	13.0	10.9
Total Absolute Return**	1.4	NA	NA	NA

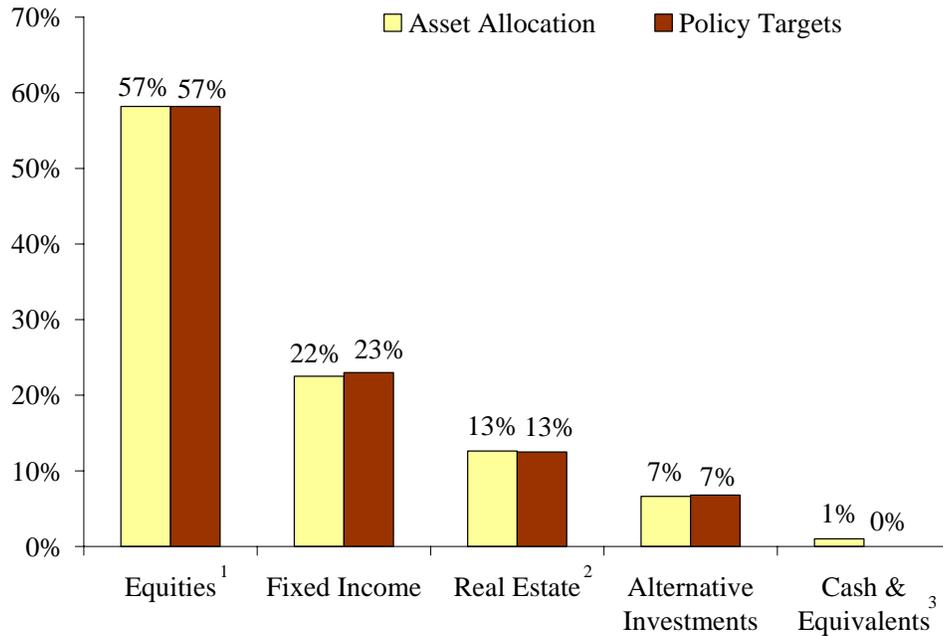
* The WRS's policy is a time weighted average of the representative asset class benchmarks.

** Other alternative investments include private equity limited partnerships that are measured by dollar-weighted, rather than time-weighted returns. For the calendar year period covered by this report, the WRS's private equity investments appreciated by \$3.9 million, including \$6.5 million in capital called and \$7.3 million in distributions. This appreciation amounts to a dollar-weighted return of approximately 13% for the calendar year period covered in this report.

Asset Allocation



Aggregate Asset Allocation vs. Policy Targets

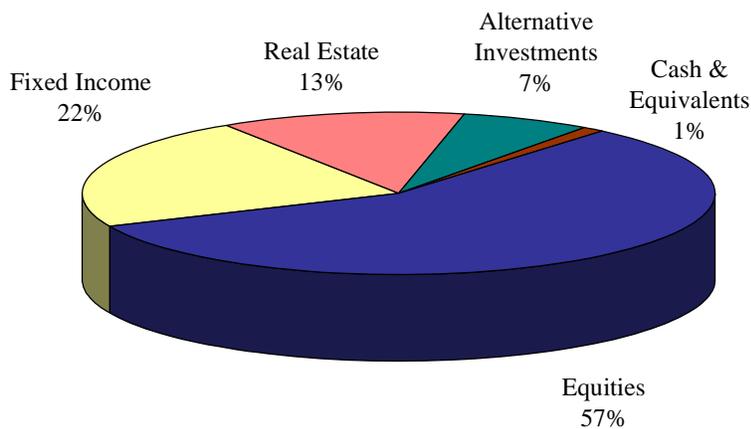


¹ Board has adopted a long-term target of 2% to Absolute Return Strategies (hedge funds). This is to be funded by reallocating assets from equities.

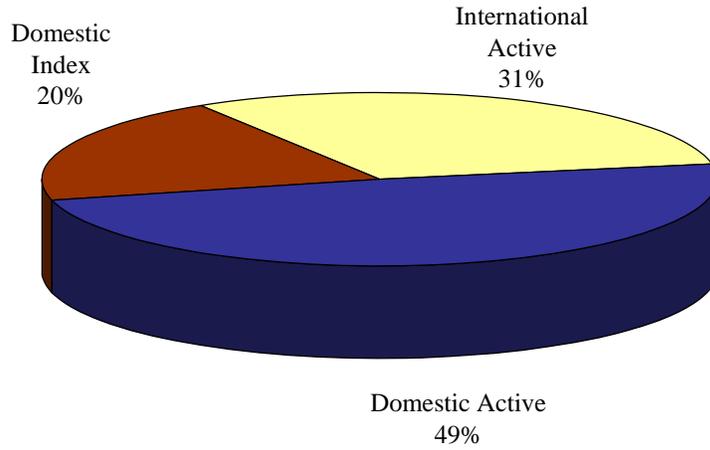
² The Real Estate policy target includes a strategic allocation to Timber of 3%.

³ Includes investment in cash held by managers within separate accounts. Less than 1% of assets were held directly in money market funds on December 31, 2005.

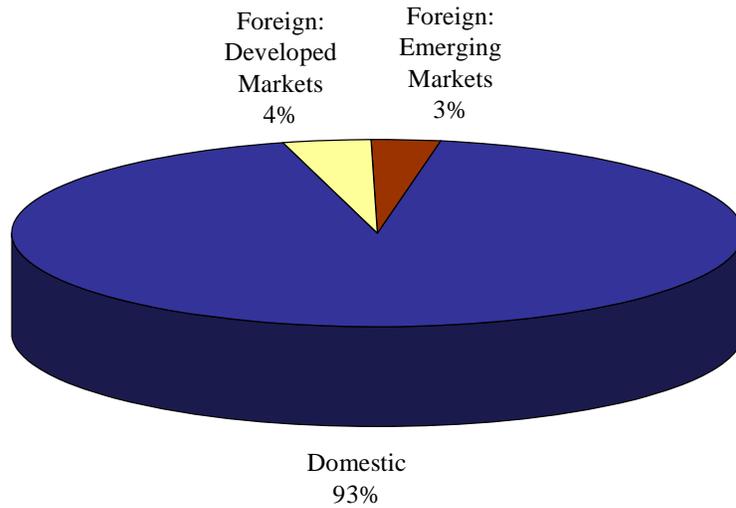
Aggregated Asset Allocation



Equity Allocation



Fixed Income Allocation



Ten Largest Stock Holdings by Fair Value

Company	Number of Shares	Fair Value (\$mm)	% of Domestic Stock	Industry
1. General Electric	143,281	5.0	2.0	Capital Goods
2. Exxon Mobil	79,000	4.4	1.8	Energy
3. Citigroup	79,231	3.8	1.5	Diversified Financials
4. Procter & Gamble	54,754	3.2	1.3	Household & Personal Products
5. Microsoft	120,910	3.2	1.2	Software & Services
6. Johnson & Johnson	47,825	2.3	1.1	Pharmaceuticals Biotechnology & Life Sciences
7. JP Morgan Chase	70,286	2.3	1.1	Diversified Financials
8. Wells Fargo	36,501	2.3	0.9	Banks
9. Goldman Sachs Group	15,426	2.0	0.8	Diversified Financials
10. United Technologies	33,638	1.9	0.7	Capital Goods

Ten Largest Fixed Income Holdings by Fair Value

Security	Coupon	Maturity Date	Number of Shares	Market Value (\$mm)	% of Bonds
1. U.S. Treasury Note Inflation Index	3.6%	4/15/2028	2,912,568	3.80	2.6
2. U.S. Treasury Note Inflation Index	3.9	4/15/2029	2,459,649	3.30	2.3
3. U.S. Treasury Bond Inflation Index	3.0	7/15/2012	2,697,566	2.90	2.0
4. U.S. Treasury Bond Inflation Index	2.0	1/15/2014	2,797,410	2.90	2.0
5. U.S. Treasury Note Inflation Index	3.9	1/15/2009	2,465,556	2.80	1.9
6. U.S. Treasury Note Inflation Index	3.4	1/15/2007	2,539,564	2.60	1.8
7. U.S. Treasury Note Inflation Index	4.1	7/15/2013	2,570,312	2.60	1.8
8. U.S. Treasury Note Inflation Index	3.5	1/15/2011	1,430,575	2.50	1.7
9. U.S. Treasury Note Inflation Index	0.9	4/15/2010	1,577,130	1.50	1.0
10. U.S. Treasury Note Inflation Index	4.2	12/31/2007	1,201,966	1.50	1.0

A complete portfolio is available upon request.

Schedule of Fees & Commissions

Investment Fees December 31, 2005	
Acadian Asset Management	\$ 95,537
Ascent Venture Management Inc IV	90,468
Ascent Venture Management, Inc. II	42,380
Ascent Venture Management, Inc. III	104,049
Bailard Real Estate Investment Trust I	282,881
Bank of Ireland Asset Mgt. Limited	(41,272)
Boston Company Asset Mgt. (Premier)	316,537
Boston Company Asset Mgt.(ACWI)	381,655
Boston Millennium Partners	77,355
Charlesbank Capital Partners V	55,985
Charlesbank Capital Partners VI	33,646
Columbia Management Adv. Inc.	252,519
Concord Partners LP	856
Duke Street Capital	8,135
Enhancement Investment Tech. LLC	228,090
Hancock	6,807
Heitman Investment Management	45,552
Hutchens Investment Mgt. Inc.	173,846
Intercontinental Real Estate Corp.	37,500
Invesco Private Capital, Inc.	37,500
L&B Realty Advisors Inc.	3,049
Loomis Sayles & Company, L.P. (Equity)	9,681
Loomis Sayles & Company, L.P. (Fixed Income)	192,505
New England Partners Capital I	37
New England Partners Capital II	22,321
Northern Trust Company	15,442
Northstar Capital LLC III	1,822
Northstar Capital LLC IV	26,213
OPUS Investment Mgt. Inc.	40,429
OPUS Investment Mgt. Inc. (Tips)	30,431
PENN Capital Management	102,775
PRIT Absolute Return	69,075
PRIT Core Real Estate	95,086
Riverside Company 2000	24,377
Riverside Company 2003	25,235
RMK Balanced B Fund	69,203
RMK Fund I	17,748
Standard Life Investments Limited	57,761
State Street Global Advisors EAFE Index	10,561
State Street Global Advisors S&P 500 Flagship	28,318
State Street Global Advisors Russell 1000 Value	2,896
VEF Advisors II	20,263
VEF Advisors III	6,133
VEF Advisors IV	10,754
Total Investment Managers Fees	<u>3,112,141</u>
IBT (Custodian Bank Fee)	207,782
State Street Bank (Custodian Bank Fee)	65,264
Meketa Investment Consultant Fee	121,000
Security Lending Fees	472,314
Total Other Fees	<u>866,360</u>
Total Investment Fees	<u>\$ 3,978,501</u>

Commissions to Brokers

Brokers	Shares	Total Commission (\$)	Commissions Per Share (\$)
A. G. EDWARDS	16,150	808	0.05
ADAMS HARKNESS, INC.	22,995	1,064	0.05
ADVEST #141	59,450	2,973	0.05
AMERICAN TECHNOLOGY RESEARCH #352	19,690	985	0.05
AMH CAPITAL DTC# 352	55,075	2,754	0.05
AVIAN SECURITIES, LLC DTC# 443	19,610	981	0.05
AVONDALE PARTNERS, LLC	75,916	4,329	0.06
BAIRD, ROBERT W., & COMPANY INC	25,489	1,234	0.05
BANK OF NEW YORK	179,000	2,685	0.02
BANKERS TRUST EQ DTC 0573	107,430	4,537	0.04
BB&T CAPITAL MARKETS DTC#702	24,555	1,214	0.05
BEAR, STEARNS & COMPANY, INC.	102,093	5,200	0.05
BNY ESI & CO #100	350,578	15,221	0.04
BOENNING & SCATTERGOOD DTC# 141	26,375	1,239	0.05
BUCKINGHAM DTC#226	35,205	1,656	0.05
C.I.S.	400	8	0.02
C.S. FIRST BOSTON EQ DTC #355	179,915	8,910	0.05
CANTOR FITZGERALD & CO	23,389	720	0.03
CE UNTERBERG, TOWBIN #226	20,760	787	0.04
CIBC WORLD MARKETS CORP	12,465	620	0.05
CITIGROUP GLOBAL MARKETS INC	4,221	211	0.05
CJS SECURITIES	7,049	281	0.04
CL KING DTC#743	3,566	160	0.04
CITATION GROUP	9,100	455	0.05
CRAIG HALLUM	2,000	96	0.05
CREDIT RESEARCH DTC #443	32,795	1,479	0.05
CS FIRST BOSTON	100,849	2,775	0.03
DAVENPORT CO DTC# 715	43,960	1,955	0.04
DAVIDSON, D.A., & COMPANY, INC.	9,988	499	0.05
DEUTSCHE BANK SECURITIES	561,648	11,233	0.02
DEUTSCHE BANK SECURITIES, INC	4,416	221	0.05
EDWARDS, A.G., & SONS, INC.	28,253	1,140	0.04
EKN #443	20,580	1,029	0.05
FIDELITY CAPITAL MARKETS - 83620	22,792	1,140	0.05
FIRST ANALYSIS SECURITIES CORP	11,290	534	0.05
FIRST CLEARING CORP	20,900	1,045	0.05
FOX-PITT KELTON INC.	1,900	95	0.05
FRIEDMAN, BILLINGS (DTC #352)	46,395	2,320	0.05

(continued)

Worcester Retirement System

Brokers	Shares	Total Commission (\$)	Commissions Per Share (\$)
FTN MIDWEST DTC# 443	1,535	61	0.04
FULCRUM GLOBAL PARTNERS LLC	12,630	632	0.05
GOLDMAN, SACHS & CO.	479,296	10,040	0.02
GUZMAN & CO	49,906	998	0.02
HOWARD WEIL #226	43,570	2,052	0.05
INSTINET	435,699	8,656	0.02
INVESTMENT TECHNOLOGY GROUP, INC	79,497	1,905	0.02
J. P. MORGAN SECURITIES INC	10,502	428	0.04
JEFFERIES & COMPANY	262,788	6,646	0.03
JMP SECURITIES #0158	85,660	3,737	0.04
JOHNSON RICE CO #352	16,115	761	0.05
JONES ASSOCIATES #155	218,170	9,690	0.04
KEEFE BRUYETTE AND WOODS INC	20,295	959	0.05
KING, C. L., & ASSOCIATES, INC.	42,516	1,428	0.03
KNIGHT EQUITY MARKETS, L.P.	55,503	2,007	0.04
LEHMAN BROTHERS INC.	125,112	5,140	0.04
LEGG MASON	2,300	115	0.05
LYNCH JONES RYAN	38,268	1,911	0.05
MCDONALD & COMPANY SECURITIES, I	40,342	1,524	0.04
MERRILL LYNCH	329,891	11,028	0.03
MERRIMAN CURHAN FORD & CO DTC# 0019	49,380	2,156	0.04
MIDWOOD SECURITIES	1,489,150	74,458	0.05
MORGAN KEEGAN & COMPANY INC.	48,272	2,334	0.05
MORGAN STANLEY	10,000	500	0.05
MS HOWELLS #0019	40,640	2,032	0.05
NATEXIS BLEICHROEDER DTC# 31	9,870	472	0.05
NATIONAL FIN SERVICES	48,400	1,452	0.03
NEEDHAM & COMPANY	17,758	859	0.05
OPPENHEIMER & CO. INC.	28,424	1,343	0.05
PAINE WEBBER (DAVE EISEN)DTC# 221	36,057	1,778	0.05
PERSHING	1,496	60	0.04
PETRIE PARKMAN DTC# 443	42,980	1,729	0.04
PRITCHARD CAPITAL #0019	65,135	2,716	0.04
PRUDENTIAL EQUITY GROUP, LLC	18,263	911	0.05
PULSE TRADING LLC	28,556	745	0.03
RAYMOND JAMES & ASSOCIATES INC.	154,566	6,031	0.04
RBC DOMINION SEC	800	40	0.05
RICHARD ROSENBLATT	392,877	7,858	0.02

(continued)

Worcester Retirement System

Brokers	Shares	Total Commission (\$)	Commissions Per Share (\$)
ROBERTSONSTEPHENS	7,118	71	0.01
ROTH CAPITAL PARTNERS DTC#0158	59,025	2,846	0.05
SANDLER, O'NEIL & PARTNERS DTC# 352	12,965	648	0.05
SBC WARBURG-DILLON	252,870	5,057	0.02
SEIDLER CO DTC # 0226	28,090	1,405	0.05
SG COWEN SECURITIES CORP	35,516	1,537	0.04
SG AMERICA SEC	800	32	0.04
SIDOTI & CO LLC	22,522	1,102	0.05
SIMMONS & CO. INTL. DTC #443	60,365	2,786	0.05
SMITH BARNEY-MADZIN #418	44,985	1,344	0.03
SOLEIL #501	67,075	3,242	0.05
STEPHENS, INC.	22,627	1,057	0.05
STERNE AGEE DTC# 0750	11,400	570	0.05
STIFEL NICOLAUS DTC# 793	10,380	455	0.04
SUNTRUST	2,600	130	0.05
THE BENCHMARK COMPANY, LLC	1,075	32	0.03
THINKEQUITY #158	4,405	176	0.04
THOMAS WEISEL PARTNERS, LLC	475	24	0.05
U S BANCORP PIPER JAFFRAY INC	8,240	98	0.01
US BANCORP INVESTMENT	1,393	42	0.03
UBS PAINE WEBBER-FRED HUDSON #642	2,645	132	0.05
UBS SECURITIES LLC	103,387	2,119	0.02
UBS WARBURG	200	4	0.02
US CLEARING	2,200	110	0.05
VANGUARD CAPITAL #279	27,235	1,362	0.05
WACHOVIA SECURITIES	1,623,213	80,991	0.05
WEALTH MONITORS #352	41,735	2,087	0.05
WEDBUSH MORGAN SECURITIES	24,450	1,105	0.05
WEEDEN AND CO	451,367	8,660	0.02
WILLIAM SMITH SECURITIES	11,793	549	0.05
WILLIAMS CAPITAL GROUP #443	11,345	567	0.05
Totals	10,073,957	382,125	0.04

(concluded)

INVESTMENT SUMMARY

	Assets (\$mm)	% of Aggregate	% of System
Total System	643.4	100	100
Total Domestic Equities	254.5	100	40
Information Technology	35.7	14	6
Financials	48.3	19	8
Health Care	42.2	17	7
Consumer Discretionary	34.1	13	5
Industrials	28.1	11	4
Energy	20.9	8	3
Consumer Staples	20.4	8	3
Materials	10.0	4	2
Utilities	9.5	4	1
Telecommunications Services	5.3	2	1
Total Fixed Income	142.8	100	22
Credit	66.2	47	10
U.S. Treasury	41.0	29	6
Cash Equivalent	1.7	1	0
Mortgage Backed	24.3	17	4
U.S. Agency	6.3	4	1
Commercial Mortgage Backed	2.9	2	1
Asset Backed	0.4	0	0
Total International Equities	115.0	100	18
Europe - Developed	64.7	56	10
Pacific Rim/Australasian - Developed	39.7	35	6
Other (Non-EAFE)	3.2	3	1
Americas (Non-EAFE)	7.4	6	1
Total Alternative Investments	122.3	100	19
Real Estate	80.2	65	12
Private Markets	29.5	25	5
Absolute Return	12.6	10	2
Cash & Equivalents	8.8	100	1

LIQUIDITY PROFILE

Benefits payments totaled approximately \$52.1 million during the year and along with other payments of \$4.6 million resulted in total cash outflows of \$56.7 million in 2005. These payments were partially offset by a contribution of approximately \$23.6 million from employers and other cash receipts of \$15.5 million for a total of \$39.1 million in 2005. This resulted in a negative cash flow of approximately \$17.6 million for the fiscal year. Note that these figures do not incorporate expected income and asset gains from the WRS's investments. The WRS's portfolio is structured with a long-term expected return of 8.6%



Actuarial Section



THE SEGAL COMPANY

116 Huntington Avenue, 8th Floor Boston, MA 02116
T 617.424.7336 F 617.424.7390 www.segalco.com

Kathleen A. Riley, FSA, MAAA, EA
Senior Vice President & Actuary
kriley@Segalco.com

May 22, 2006

City of Worcester Retirement Board
City Hall, Room 103
455 Main Street
Worcester, MA 01608

Dear Board Members:

The Segal Company has performed a January 1, 2006 actuarial valuation of the Worcester Retirement System. This actuarial valuation has been completed in accordance with generally accepted actuarial principles and practices. To the best of our knowledge, the information supplied in this actuarial valuation is complete and accurate. Further, in our opinion, the assumptions as approved by the Retirement Board are reasonably related to the experience of and the expectations for the Plan.

As part of performing the valuation, The Segal Company was furnished member data by the City of Worcester Retirement System's administrative staff. Although examined for general reasonableness, the data was not audited by the actuary. In addition, the administrative staff furnished financial statements that were not audited by the actuary.

The funding objective of the plan is to provide for the current cost of benefits (*i.e.*, normal cost) and to reduce the unfunded liability to zero by June 30, 2023. The normal cost is expected to remain at a level percentage of payroll. The remaining liability of the 2002 ERI is amortized over a 12-year period (by June 30, 2018) in payments which increase at the rate of 1.5% per year. The 2003 ERI liability is amortized over a 6-year period (by June 30, 2012) with level payments. The Section 90 ACD liability is amortized over an 8-year period (by June 30, 2014) with level payments. The remaining unfunded liability is amortized over a 17-year period with payments increasing at the rate of 4.5% per year. The contribution will increase by approximately 4% per year, except for years when the ERI and Section 90 ACD liabilities are fully amortized.

The funding objective as of the prior valuation was the same with the exception of the 2003 ERI liability. In the prior valuation, the 2003 ERI liability was scheduled to be fully amortized by 2019. An additional contribution of \$1,175,586 made on July 1, 2005 was applied to the 2003 ERI liability.

Actuarial valuations have been performed annually. This is consistent with the guidelines promulgated by PERAC and GASB. The last valuation was performed as of January 1, 2006.

The assumptions and methods used for funding purposes met the parameters set for the disclosures presented in the financial section by GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*.

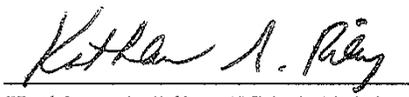
The Segal Company has prepared, and included as part of this report, all the supporting schedules for the Actuarial Section and Statistical Section of the CAFR. In addition, we have prepared the Schedules of Funding Progress and the Schedule of Employer Contributions found in the Financial Section of the CAFR.

Please let us know if you have any questions on this material.

Sincerely,

THE SEGAL COMPANY

By:


Kathleen A. Riley, FSA, MAAA
Senior Vice President and Actuary

I. Summary of Actuarial Assumptions and Actuarial Cost Method

The actuarial assumptions, as set forth in the accompanying supporting schedules, were selected by the Worcester Retirement Board and actuary. Unless stated otherwise, the actuarial assumptions are based upon the actuarial valuation as of January 1, 2006, which was adopted by the WRS on April 25, 2006.

Mortality Rates

<i>Healthy</i>	1994 Group Annuity Mortality Table
<i>Disabled</i>	1994 Group Annuity Mortality Table set forward 10 years

Termination Rates before Retirement

Age	Rate (%)			
	Mortality		Group 1 and 2	
	Male	Female	Disability	Withdrawal
20	0.05	0.03	0.02	12.00
25	0.07	0.03	0.03	8.78
30	0.08	0.04	0.04	5.55
35	0.09	0.05	0.05	3.93
40	0.11	0.07	0.07	2.31
45	0.16	0.10	0.13	1.89
50	0.26	0.14	0.19	1.46
55	0.44	0.23	0.29	0.00
60	0.80	0.44	0.38	0.00

Notes: 55% of the disability rates shown represent accidental disability.
20% of the accidental disabilities will die from the same cause as the disability.
55% of the death rates shown represent accidental death.

Age	Rate (%)			
	Mortality		Group 4	
	Male	Female	Disability	Withdrawal
20	0.05	0.03	0.08	2.10
25	0.07	0.03	0.12	1.88
30	0.08	0.04	0.17	1.65
35	0.09	0.05	0.41	1.11
40	0.11	0.07	0.65	0.56
45	0.16	0.10	0.89	0.28
50	0.26	0.14	1.13	0.00
55	0.44	0.23	1.33	0.00
60	0.80	0.44	1.53	0.00

Notes: 90% of the disability rates shown represent accidental disability.
60% of the accidental disabilities will die from the same cause as the disability.
90% of the death rates shown represent accidental death.

Retirement Rates

Rate (%)			
Age	Groups 1 and 2	Age	Group 4
55	12.55	50	32.00
56	3.21	51	7.21
57	3.10	52	5.90
58	3.34	53	8.00
59	3.48	54	7.71
60	7.84	55	15.51
61	6.92	56	9.11
62	15.11	57	9.09
63	10.71	58	11.90
64	10.37	59	11.42
65	35.68	60	23.95
66	22.14	61	13.60
67	21.59	62	19.50
68	21.64	63	12.53
69	25.36	64	18.73
70	100.00	65	100.00

Unknown Data for Participants

Same as those exhibited by participants with similar known characteristics.

Age of Spouse

Female (or male) spouses 3 years younger (or older) than their spouses.

Percent-Married

80%

Net Investment Return

8.25%

Salary Increases

Age	Present salary as a percent of salary at 65 (%)	Annual increase rate (%)
20	11.13	5.00
25	14.20	5.00
30	18.13	5.00
35	23.14	5.00
40	29.53	5.00
45	37.69	5.00
50	48.10	5.00
55	61.39	5.00
60	78.35	5.00

Includes allowance for inflation of 4.00%.

Administrative Expenses

\$600,000 for calendar 2006

Actuarial Value of Assets

Market value

2005 Salary

2005 salary equal to salaries provided in the data, except for new hires where salaries were calculated from annualized contributions divided by the contribution rate(s) reported. The salaries of police officers were reduced by 2.25% to adjust for retroactive pay amounts. The salaries of participants in unions identified by the City were adjusted by 4% to reflect unsettled bargaining agreements.

Total Service

Total creditable service based on adjusted date of hire, except special cases where date of hire was used.

Actuarial Cost Method

Entry Age Normal Actuarial Cost Method. Entry Age is the age of the participant at the Adjusted Date of Hire. Normal Cost and Actuarial Accrued Liability are calculated on an individual basis and are allocated by salary.

Recent Changes

The investment return assumption was lowered from 8.50% to 8.25% as of January 1, 2006.

The salary increase assumption was lowered January 1, 2004 from 5.50% to 5.00%. An asset smoothing method was first applied with the January 1, 2000 valuation and modified as of January 1, 2004.

As of December 31, 2004, the actuarial value of assets was set equal to market value. Market value will be used thereafter.

II. Schedule of Active Member Valuation Data

<u>Valuation date</u>	<u>Number</u>	<u>Projected annual payroll (\$)</u>	<u>Annual average pay (\$)</u>	<u>% Increase in average pay</u>
1/1/2001	3,910	136,000,517	34,783	2.45
1/1/2002	4,080	148,764,543	36,462	4.82
1/1/2003	3,679	142,802,508	38,816	6.45
1/1/2004	3,409	138,796,895	40,715	4.89
1/1/2005	3,498	147,126,606	42,060	3.30
1/1/2006	3,430	145,830,593	42,516	1.08

III. Schedule of Retirants and Beneficiaries Added to and Removed from Rolls

<u>Year ended</u>	<u>Added to Rolls</u>		<u>Removed from Rolls</u>		<u>Rolls - end of year</u>		<u>% Increase in annual allowances</u>	<u>Average annual allowances</u>
	<u>Number</u>	<u>Annual allowances¹</u>	<u>Number</u>	<u>Annual allowances</u>	<u>Number</u>	<u>Annual allowances¹</u>		
2000	106	\$ 2,338,770	128	N/A	2,950	\$ 40,034,838	7.90	\$ 13,571
2001	86	2,057,603	131	N/A	2,905	41,736,155	4.25	14,367
2002	216	6,081,952	120	N/A	3,001	47,173,651	13.03	15,719
2003	115	3,212,097	120	N/A	2,996	49,606,369	5.16	16,558
2004	77	2,031,304	106	N/A	2,967	51,566,334	3.95	17,380
2005	76	1,890,735	124	N/A	2,919	52,623,545	2.05	18,028

¹ Annual allowances are shown for retirees in pay status at the end of the year.

IV. Solvency Test

Valuation Date	Actuarial Accrued Liability				Portion of Actuarial Accrued Liability Covered by Assets		
	(1)	(2)	(3)	Actuarial value of assets	(1)	(2)	(3)
	Active member contributions	Retirees and beneficiaries	Active/Inactive members (Employer financed)				
1/1/2001	\$ 104,242,043	327,801,840	196,637,600	630,714,618	100	100	100
1/1/2002	111,769,704	342,266,770	217,840,469	620,814,307	100	100	77
1/1/2003	111,507,319	397,136,220	207,212,025	554,190,090	100	100	22
1/1/2004	115,779,891	418,037,422	209,753,127	577,123,067	100	100	21
1/1/2005	122,748,711	425,655,839	223,543,701	606,099,616	100	100	26
1/1/2006	130,292,926	438,740,267	237,924,271	644,016,504	100	100	32

V. Analysis of Financial Experience

	Year Ended December 31,			
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
1. Unfunded actuarial accrued liability as of January 1	\$ 165,848,695	166,447,373	161,665,474	51,062,636
2. Normal cost as of January 1	20,362,054	19,170,321	19,902,898	21,597,468
3. Employer and employee contributions during year	(35,484,556)	(31,843,173)	(29,261,377)	(24,139,117)
4. Interest				
(a) For whole year on (1)+(2)	15,827,913	15,777,504	15,433,311	6,176,109
(b) For half year on (3)	(1,362,059)	(1,222,286)	(1,123,184)	(926,569)
(c) Total interest	<u>14,465,854</u>	<u>14,555,218</u>	<u>14,310,127</u>	<u>5,249,540</u>
5. Expected unfunded actuarial liability	<u>165,192,047</u>	<u>168,329,739</u>	<u>166,617,122</u>	<u>53,770,527</u>
6. Actual unfunded actuarial accrued liability	<u>162,940,960</u>	<u>165,848,695</u>	<u>166,447,373</u>	<u>161,665,474</u>
7. (Gain) or loss for the year: (6)-(5)	<u>\$ (2,251,087)</u>	<u>(2,481,044)</u>	<u>(169,749)</u>	<u>107,894,947</u>
8. Investment (gain) or loss	\$ (4,698,351)	405,058	4,639,654	98,499,864
9. (Gains) or losses from sources other than investments	(14,912,389)	(5,367,076)	(8,634,577)	3,781,977
10. Plan changes	370,567	2,480,974	3,825,174	12,987,821
11. Assumption changes	16,989,086	-	-	(7,347,715)

VI. Summary of Plan Provisions

The following summarizes the major provisions of Chapter 32 of the Massachusetts General Laws.

Plan Year

January 1 – December 31

Retirement Benefit

Employees covered by the Contributory Retirement Law are classified into one of four groups depending on job classification. Group 1 comprises most positions in state and local government. It is the general category of public employees. Group 4 comprises mainly police and firefighters. Group 2 is for other specified hazardous occupations. (Officers and inspectors of the State Police are classified as Group 3.)

The annual amount of the retirement allowance is based on the member's final three-year average salary multiplied by the number of years and full months of creditable service at the time of retirement and multiplied by a percentage according to the following table based on the age of the member at retirement.

Age Last Birthday at Date of Retirement

Percent	Group 1	Group 2	Group 4
2.5	65 or over	60 or over	55 or over
2.4	64	59	54
2.3	63	58	53
2.2	62	57	52
2.1	61	56	51
2.0	60	55	50
1.9	59	--	49
1.8	58	--	48
1.7	57	--	47
1.6	56	--	46
1.5	55	--	45

A member's final three-year average salary is defined as the greater of the highest consecutive three-year average annual rate of regular compensation and the average annual rate of regular compensation received during the last three years of creditable service prior to retirement. The \$30,000 cap on salary used in a benefit determination for any employee hired after January 1, 1979 has been removed.

The maximum annual amount of the retirement allowance is 80 percent of the member's final three-year average salary. Any member who is a veteran also receives an additional yearly retirement allowance of fifteen dollars per year of creditable service, not exceeding three hundred dollars. The veteran allowance is paid in addition to the 80 percent maximum.

Employee Contributions

Employees hired before January 1, 1975 contribute 5 percent of their salary; employees hired after December 31, 1974 and before January 1, 1984 contribute 7 percent; employees hired after January 1, 1984 contribute 8 percent; employees hired after July 1, 1996 contribute 9 percent.

In addition, employees hired after December 31, 1978 contribute an additional 2 percent of salary in excess of \$30,000.

Employees hired after 1983 who leave with less than five years of credited service receive no interest on their contributions and employees who leave with five but less than ten years receive one-half the rate of regular interest otherwise payable.

Retirement Benefits (Superannuation)

Members of Group 1, 2 or 4 may retire upon the attainment of age 55. For retirement at ages below 55, twenty years of creditable service is required.

Members who terminate before age 55 with ten or more years of creditable service are eligible for a retirement allowance upon the attainment of age 55 (provided they have not withdrawn their accumulated deductions from the Annuity Savings Fund of the WRS).

Ordinary Disability Benefits

A member who is unable to perform his job due to a non-occupational disability will receive a retirement allowance if he has ten or more years of creditable service and has not reached age 55. The annual amount of such allowance shall be determined as if the member retired for superannuation at age 55, based on the amount of creditable service at the date of disability. For veterans, there is a minimum benefit of 50 percent of the member's most recent year's pay plus an annuity based on his own contributions.

Accidental Disability Benefit

For a job-connected disability the benefit is 72 percent of the member's most recent annual pay plus an annuity based on his own contributions, plus additional amounts for surviving children. Benefits are capped at 75 percent of annual rate of regular compensation for employees who become members after January 1, 1988.

Death Benefits

In general, the beneficiary of an employee who dies in active service will receive a refund of the employee's own contributions. Alternatively, if the employee were eligible to retire on the date of his death, a spouse's benefit will be paid equal to the amount the employee would have received under Option C. The surviving spouse of a member who dies with two or more years of credited service has the option of a refund of the employee's contributions or a monthly benefit regardless of eligibility to retire, if they were married for at least one year. There is also a minimum widow's pension of \$500 per month, and there are additional amounts for surviving children.

If an employee's death is job-connected, the spouse will receive 72 percent of the member's most recent annual pay in addition to a refund of the member's accumulated deductions, plus additional amounts for surviving children. However, in accordance with Section 100 of Chapter 32, the surviving spouse of a police officer, firefighter or corrections officer is killed in the line of duty will be eligible to receive an annual benefit equal to the maximum salary held by the member at the time of death.

"Heart and Lung Law" and Cancer Presumption

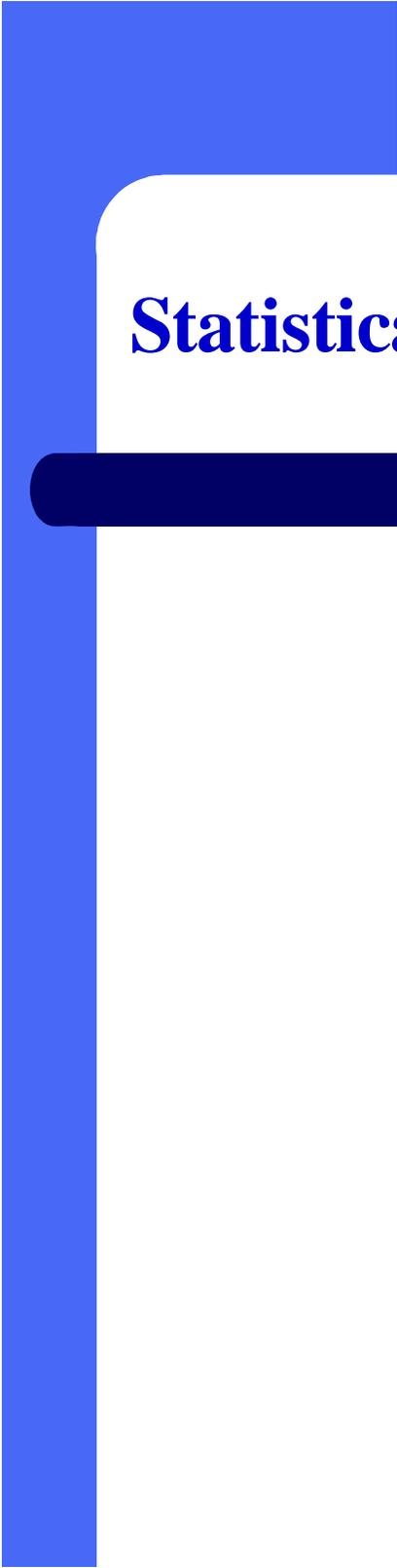
Any case of hypertension or heart disease resulting in total or partial disability or death to a uniformed fireman or permanent member of a police department is presumed to have been suffered in the line of duty, unless the contrary is shown by competent evidence. Any case of disease of the lungs or respiratory tract resulting in total disability or death to a uniformed fireman is presumed to have been suffered in the line of duty, unless the contrary is shown by competent evidence. There is an additional presumption for uniformed firemen that certain types of cancer are job-related if onset occurs while actively employed or within five years of retirement.

Options

Members may elect to receive a full retirement allowance payable for life under Option A. Under Option B a member may elect to receive a lower monthly allowance in exchange for a guarantee that at his death any of his contributions not expended for annuity payments will be refunded to his beneficiary. Option C allows the member to take a lesser retirement allowance in exchange for providing his survivor with two-thirds of the lesser amount. Option C pensioners will have their benefits converted from a reduced to a full retirement if the beneficiary predeceases the retiree.

Post-Retirement Benefits

The Board has adopted the provisions of Section 51 Chapter 127 of the Acts of 1999, which provide that the Retirement Board may approve an annual COLA in excess of the Consumer Price Index but not to exceed a 3% COLA on the first \$12,000 of a retirement allowance. Cost-of-living increases granted prior to July 1, 1998 are reimbursed by the Commonwealth and are not reflected in this report.



Statistical Section



Schedule of Additions to Plan Net Assets by Source

<u>Fiscal Year</u>	<u>Employee Contributions</u>	<u>Employer Contributions</u>	<u>Employer Contributions as % of Covered Payroll</u>	<u>Investment Income(a)</u>	<u>Other(b)</u>	<u>Total</u>
2000	\$ 10,641,408	8,343,309	6.70	\$ 3,874,421	4,517,210	27,376,348
2001	11,875,466	9,480,000	6.52	(29,629,122)	3,442,841	(4,830,815)
2002	12,393,094	12,956,778	8.52	(67,805,128)	3,615,546	(38,839,710)
2003	11,691,887	18,928,252	13.00	115,614,944	2,783,268	149,018,351
2004	12,187,208	20,150,377	14.24	66,454,940	3,530,693	102,323,218
2005	12,509,613	23,579,478	16.03	55,470,779	3,015,645	94,575,515

(a) Net of Investment expenses

(b) Includes state pension reimbursements and transfer of employee' contributions from other public pension plans as defined by Massachusetts General Law, Chapter 32.

Schedule of Deductions from Plan Net Assets by Type

<u>Fiscal Year</u>	<u>Benefits</u>	<u>Administrative Expenses</u>	<u>Withdrawals(a)</u>	<u>Total</u>
2000	\$ 39,696,596	1,428,037	2,659,748	43,784,381
2001	41,095,677	811,315	3,129,455	45,036,448
2002	43,540,572	561,697	3,802,339	47,904,608
2003	47,848,502	440,294	3,866,838	52,155,634
2004	50,517,094	518,078	3,704,908	54,740,080
2005	52,105,583	556,781	3,996,263	56,658,627

(a) Includes amounts for employee withdrawals and employee transfers to other state agencies.

Schedule of Retired Members by Type of Benefit

	12/31/2005	12/31/2004	12/31/2003	12/31/2002	12/31/2001	12/31/2000
Superannuation						
Group 1	1,577	1,622	1,653	1,653	1,589	1,621
Group 2&4	269	270	262	254	220	224
Total	1,846	1,892	1,915	1,907	1,809	1,845
Ordinary Disability						
Group 1	44	41	42	42	41	46
Group 2&4	6	5	7	6	6	6
Total	50	46	49	48	47	52
Accidental Disability						
Group 1	139	139	140	147	147	152
Group 2&4	323	321	315	319	316	313
Total	462	460	455	466	463	465
Beneficiaries						
Group 1	389	395	408	417	427	438
Group 2&4	172	174	169	163	159	150
Total	561	569	577	580	586	588
Total Retired Members						
Group 1	2,149	2,197	2,243	2,259	2,204	2,257
Group 2&4	770	770	753	742	701	693
Total	2,919	2,967	2,996	3,001	2,905	2,950

Source: Actuarial valuation as of January 1, 2006

Schedule of Benefit Expenses by Type

Year ended December 31	Regular	Disability	Beneficiary	COLA	Annuities	Total
2000	\$ 16,423,542	7,785,392	4,621,538	6,217,596	4,648,528	39,696,596
2001	17,082,481	7,872,843	4,737,758	6,771,240	4,631,355	41,095,677
2002	18,332,032	8,532,815	4,771,934	7,056,425	4,847,366	43,540,572
2003	21,186,242	8,706,365	5,105,775	7,422,192	5,427,928	47,848,502
2004	22,505,296	9,192,940	5,145,320	7,795,981	5,877,557	50,517,094
2005	22,855,516	9,796,237	4,830,540	8,581,377	6,041,913	52,105,583

Schedule of Average Benefit Payments

<u>Year ended December 31</u>	<u>Number</u>	<u>Annual benefits (\$)</u>	<u>Annual average (\$)</u>	<u>% Increase</u>
2000	2,950	39,696,596	13,456	8.48
2001	2,905	41,095,677	14,147	5.13
2002	3,001	43,540,572	14,509	2.56
2003	2,996	47,848,502	15,971	10.08
2004	2,967	50,517,094	17,026	6.61
2005	2,919	52,105,583	17,850	4.84

Schedule of Participating Employers

Employer Name

City of Worcester
Worcester Housing Authority

Source: The WRS administrative staff