TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: S.F. 1519 (Pogemiller); H.F. 1615 (Smith): MTRFA; Pension Obligation Bonds and Funding Changes

DATE: April 19, 2005

General Summary of S.F.1519 (Pogemiller); H.F. 1615 (Smith)

S.F. 1519 (Pogemiller); H.F. 1615 (Smith) amends various provisions of Minnesota Statutes, Chapters 128D, 354, 354A, and 423, the statutory chapters relating to Special School District No. 1, Minneapolis, the Teachers Retirement Association (TRA), the first class city teacher retirement fund associations, and the pension amortization aid program, by making the following changes:

1. Authorizes Minneapolis School District Pension Obligation Bonds. Special School District No. 1, Minneapolis, is authorized to issue an unspecified amount of pension obligation bonds to fund a portion of the unfunded actuarial accrued liability of the Minneapolis Teachers Retirement Fund Association (MTRFA), with the bonds funded in whole or in part from the current state aid to MTRFA, and any additional bond costs certified by the Minneapolis school superintendent to the Commissioner of Finance for a potential additional state appropriation. The proceeds of the bond issue must be deposited in an unspecified investment fund with the State Board of Investment and are not considered an MTRFA asset until transferred to the plan upon certification by the MTRFA board of trustees (Sections 1 and 12).

2. Consolidates the MTRFA Coordinated Program Retirees and All MTRFA Active Members into TRA. All active Minneapolis School District teachers, the Minneapolis Teachers Retirement Fund Association (MTRFA) employees previously covered by the MTRFA Coordinated Program, and the MTRFA Coordinated Program retirees are transferred to the Teachers Retirement Association (TRA), with former active members of the MTRFA Coordinated Program receiving TRA service credit for their prior service as an employee of the Minneapolis Public Schools or of the MTRFA. Assets equal to the funded ratio of TRA applied to the required reserves of MTRFA Coordinated Program annuitants are transferred from MTRFA to TRA (Sections 2, 3, 6, 8, and 15).

3. Five Percent Member and Employer Contributions for Minneapolis Teachers in TRA. The contribution rates for and on behalf of Minneapolis teachers covered by the Teachers Retirement Association (TRA) are set at five percent of covered salary each (Sections 4 and 5).

4. Rededication of State Aid to MERF. Fiscal Year 2003-2004 state aid to the Minneapolis Employees Retirement Fund (MERF) that is unspent by MERF is rededicated to the Minneapolis Teachers Retirement Fund Association (MTRFA) (Section 7).

5. 1993 MTRFA State Aid Matching Local Contributions Made Mandatory. The contributions by the City of Minneapolis and by Special School District No. 1, Minneapolis, to gain matching state aid, begun in 1993, is made mandatory rather than permissive (Section 9).

6. Additional State, City, and School District MTRFA Funding. Immediately prior to a Minneapolis Teachers Retirement Fund Association (MTRFA) funding default, the MTRFA board of trustees is required to certify to the Commissioner of Finance the annual amount of MTRFA Basic Program benefits payable and the expected MTRFA administrative expenses, with one-third of that amount then charged against the state local government aid otherwise payable to the City of Minneapolis, one-third of that amount charged against the state education aid otherwise payable to the Minneapolis Public Schools, and one-third payable from an open-end standing appropriation from the State General Fund (Section 10).

7. MTRFA Basic Program Post-Retirement Adjustments Five Percent Maximum. A five percent maximum is placed on MTRFA Basic Program post-retirement adjustments (Section 10, Paragraph (c)).

8. Minimum Investment Performance Condition on 1996 MTRFA and SPTRFA Additional Amortization Aid Eliminated. The minimum investment performance requirement on which the allocation of a portion of additional amortization state aid is conditioned, begun in 1996, is eliminated for the Minneapolis Teachers Retirement Fund Association (MTRFA) and the St. Paul Teachers Retirement Fund Association (SPTRFA) (Section 11).

9. Resets MTRFA Amortization Target Date to 2030. The amortization target date for the Minneapolis Teachers Retirement Fund Association (MTRFA) is reset to 2030 (Section 13).

10. MTRFA Staffing Protections. No job loss, salary reduction, or employment benefit reduction for employees of the Minneapolis Teachers Retirement Fund Association (MTRFA) can occur on account of the MTRFA reorganization, through at least July 1, 2009 (Section 14).

11. Repeal of the MTRFA Post-Retirement Adjustment Mechanism. Minnesota Statutes, Section 354A.28, the Minneapolis Teachers Retirement Fund Association (MTRFA) post-retirement adjustment mechanism, is repealed (Section 16).

Section-by-Section Summary of S.F. 1519 (Pogemiller); H.F. 1615 (Smith)

A section-by-section summary of the proposed legislation is attached.

Background Information on the Minneapolis Teachers Retirement Fund Association (MTRFA)

A. Establishment and Operation. Background information in the establishment and operation of the Minneapolis Teachers Retirement Fund Association (MTRFA) is contained in Attachment A.

B. Funding Problems. Background information on the funding problems of the Minneapolis Teachers Retirement Fund Association (MTRFA) is contained in Attachment B.

C. Financial Requirements and Contributions. Background information on the financial requirements of the Minneapolis Teachers Retirement Fund Association (MTRFA) and the contributions to the plan is contained in Attachment C.

D. Investment Performance. Background information on the investment performance of the Minneapolis Teachers Retirement Fund Association (MTRFA) is contained in Attachment D.

Actuarial Condition of the Minneapolis Teachers Retirement Fund Association (MTRFA)

The Minneapolis Teachers Retirement Fund Association (MTRFA) has had a history of problematic actuarial results and its current actuarial condition is its worst since 1990 in terms of the plan's funding ratio and is its worst ever in terms the plan's funding level deficiency as a percentage of covered pay and as a dollar figure. The following summarizes the funded condition and financial requirements of MTRFA every five years for the last 35 years as indicated in the official actuarial valuation reports for the plan:

	1969		1974		1979		1984	
Membership								
Active Members		4,197		3,942		3,149		3,099
Service Retirees		1,720		1,911		2,060		2,371
Disabilitants		30		40		60		0
Survivors		130		89		81		0
Deferred Retirees		183		211		445		0
Nonvested Former Members		0		0		0		0
Total Membership		6,260		6,193		5,795		5,470
Funded Status								
Accrued Liability		$148,835,491		$162,948,618		$333,302,046		$492,478,638
Current Assets		$56,568,831		$92,928,061		$137,172,512		$223,334,253
Unfunded Accrued Liability		$92,266,660		$70,020,557		$196,129,534		$269,144,385
Funding Ratio	38.01%		57.03%		41.16%		45.35%	
Financing Requirements								
Covered Payroll		$38,564,873		$53,657,729		$62,138,567		$82,035,896
Benefits Payable		$5,825,023		$7,476,776		$11,482,837		$17,265,960
Normal Cost	19.56%	$7,543,289	12.07%	$6,476,488	14.42%	$8,960,381	14.55%	$11,936,223
Administrative Expenses	0.46%	$177,398	0.49%	$262,923	0.64%	$397,687	0.82%	$672,694
Normal Cost & Expense	20.02%	$7,720,688	12.56%	$6,739,411	15.06%	$9,358,068	15.37%	$12,608,917
Normal Cost & Expense	20.02%	$7,720,688	12.56%	$6,739,411	15.06%	$9,358,068	15.37%	$12,608,917
Amortization	12.10%	$4,666,350	9.01%	$4,834,561	20.53%	$12,757,048	19.08%	$15,652,449
Total Requirements	32.12%	$12,387,037	21.57%	$11,573,972	35.59%	$22,115,116	34.45%	$28,261,366
Employee Contributions	6.50%	$2,506,717	6.50%	$3,487,752	8.40%	$5,219,640	8.02%	$6,579,279

	1969		1974		1979		1984	
Employer Contributions	6.50%	$2,506,717	6.50%	$3,487,752	13.14%	$8,165,008	12.29%	$10,082,212
Employer Add'l Cont.	9.52%	$3,671,376	9.39%	$5,038,461	0.00%	$0	0.00%	$0
Direct State Funding	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0
Other Govt. Funding	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0
Administrative Assessment	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0
Total Contributions	22.52%	$8,684,809	22.39%	$12,013,966	21.54%	$13,384,647	20.31%	$16,661,490
Total Requirements	32.12%	$12,387,037	21.57%	$11,573,972	35.59%	$22,115,116	34.45%	$28,261,366
Total Contributions	22.52%	$8,684,809	22.39%	$12,013,966	21.54%	$13,384,647	20.31%	$16,661,490
Deficiency (Surplus)	9.60%	$3,702,228	(0.82%)	($439,993)	14.05%	$8,730,469	14.14%	$11,599,876
Amortization Target Date	1997		1997		2009		2009	
Actuary	Flott		Peat, Marwick & Mitchell		Peat, Marwick & Mitchell		Mercer Meidinger	

	1989		1994		1999		2004	
Membership								
Active Members		3,164		4,484		5,308		5,074
Service Retirees		2,171		2,497		2,881		3,449
Disabilitants		38		48		21		24
Survivors		197		219		243		291
Deferred Retirees		525		652		715		1,243
Nonvested Former Members		139		671		1,628		3,384
Total Membership		6,234		8,571		10,796		13,465
Funded Status								
Accrued Liability		$781,132,000		$920,470,000		$1,394,357,000		$1,729,551,327
Current Assets		$385,146,000		$514,138,000		$939,459,000		$877,763,977
Unfunded Accrued Liability		$395,986,000		$406,332,000		$454,898,000		$851,787,350
Funding Ratio	49.31%		55.86%		67.38%		50.75%	
Financing Requirements								
Covered Payroll		$118,036,000		$165,789,000		$242,288,000		$249,069,999
Benefits Payable		$30,859,000		$48,209,000		$75,813,000		$118,352,032
Normal Cost	13.75%	$16,229,950	12.36%	$20,491,520	10.90%	$26,411,000	9.59%	$23,889,438
Administrative Expenses	1.78%	$2,101,041	0.36%	$596,840	0.23%	$559,000	0.28%	$697,396
Normal Cost & Expense	15.53%	$18,330,991	12.72%	$21,088,361	11.13%	$26,970,000	9.87%	$24,586,834
Normal Cost & Expense	15.53%	$18,330,991	12.72%	$21,088,361	11.13%	$26,970,000	9.87%	$24,586,834
Amortization	14.75%	$17,410,310	12.31%	$20,408,626	12.75%	$30,881,000	28.24%	$70,337,368
Total Requirements	30.28%	$35,741,301	25.03%	$41,496,987	23.88%	$57,851,000	38.11%	$94,924,202
Employee Contributions	7.37%	$8,699,253	6.25%	$10,361,813	6.21%	$15,035,000	5.78%	$14,405,402
Employer Contributions	10.84%	$12,795,102	9.89%	$16,396,532	9.08%	$22,001,000	8.52%	$21,216,367
Employer Add'l Cont.	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0
Direct State Funding	0.00%	$0	1.51%	$2,500,000	7.47%	$18,094,000	7.56%	$18,829,000
Other Govt. Funding	0.00%	$0	1.51%	$2,500,000	1.03%	$2,500,000	1.00%	$2,500,000
Administrative Assessment	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0
Total Contributions	18.21%	$21,494,356	19.16%	$31,758,345	23.79%	$57,630,000	22.87%	$56,950,769
Total Requirements	30.28%	$35,741,301	25.03%	$41,496,987	23.88%	$57,851,000	38.11%	$94,924,202
Total Contributions	18.21%	$21,494,356	19.16%	$31,758,345	23.79%	$57,630,000	22.87%	$56,950,769
Deficiency (Surplus)	12.07%	$14,246,945	5.87%	$9,738,642	0.09%	$221,000	15.24%	$37,973,433
Amortization Target Date	2020		2020		2020		2020	
Actuary	Wyatt		Milliman & Robertson		Milliman & Robertson		Segal	

If the market value of assets, rather than the actuarial (averaged) value of assets, were used to determine the funded condition and the financial requirements of the MTRFA, the current funding situation of the retirement plan is worse, as indicated for fiscal years 2003 and 2004, as follows:

	2003				2004			
	Valuation Results Actuarial Value of Assets		Adjusted Valuation Results Market Value of Assets		Valuation Results Actuarial Value of Assets		Adjusted Valuation Results Market Value of Assets	
Membership								
Active Members		5,381		5,381		5,074		5,074
Service Retirees		3,334		3,334		3,449		3,449
Disabilitants		23		23		24		24
Survivors		285		285		291		291
Deferred Retirees		1,123		1,123		1,243		1,243
Nonvested Former Members		3,057		3,057		3,384		3,384
Total Membership		13,203		13,203		13,465		13,465
Funded Status								
Accrued Liability		$1,671,982,000		$1,671,982,000		$1,729,551,327		$1,729,551,327
Current Assets		$956,913,000		$719,599,000		$877,763,977		$763,089,276
Unfunded Accrued Liability		$715,069,000		$952,383,000		$851,787,350		$966,462,051
Funding Ratio	57.23%		43.04%		50.75%		44.91%	
Financing Requirements								
Covered Payroll		$264,766,000		$264,766,000		$249,069,999		$249,069,999

	2003				2004			
	Valuation Results Actuarial Value of Assets		Adjusted Valuation Results Market Value of Assets		Valuation Results Actuarial Value of Assets		Adjusted Valuation Results Market Value of Assets	
Benefits Payable		$113,649,000		$113,649,000		$118,352,032		$118,352,032
Normal Cost	10.36%	$27,426,000	10.36%	$27,426,000	9.59%	$23,889,438	9.59%	$23,889,438
Administrative Expenses	0.30%	$794,000	0.30%	$794,000	0.28%	$697,396	0.28%	$697,396
Normal Cost & Expense	10.66%	$28,220,000	10.66%	$28,220,000	9.87%	$24,586,834	9.87%	$24,586,834
Normal Cost & Expense	10.66%	$28,220,000	10.66%	$28,220,000	9.87%	$24,586,834	9.87%	$24,586,834
Amortization	21.30%	$56,395,000	28.37%	$75,111,000	28.24%	$70,337,368	32.04%	$79,806,764
Total Requirements	31.96%	$84,615,000	39.03%	$103,331,000	38.11%	$94,924,202	41.91%	$104,393,598
Employee Contributions	5.84%	$15,460,000	5.84%	$15,460,000	5.78%	$14,405,402	5.78%	$14,405,402
Employer Contributions	8.59%	$22,750,000	8.59%	$22,750,000	8.52%	$21,216,367	8.52%	$21,216,367
Employer Add'l Cont.	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0
Direct State Funding	7.11%	$18,829,000	7.11%	$18,829,000	7.56%	$18,829,000	7.56%	$18,829,000
Other Govt. Funding	0.94%	$2,500,000	0.94%	$2,500,000	1.00%	$2,500,000	1.00%	$2,500,000
Administrative Assessment	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0
Total Contributions	22.49%	$59,539,000	22.49%	$59,539,000	22.87%	$56,950,769	22.87%	$56,950,769
Total Requirements	31.96%	$84,615,000	39.03%	$103,331,000	38.11%	$94,924,202	41.91%	$104,393,598
Total Contributions	22.49%	$59,539,000	22.49%	$59,539,000	22.87%	$56,950,769	22.87%	$56,950,769
Deficiency (Surplus)	9.47%	$25,076,000	16.54%	$43,792,000	15.24%	$37,973,433	19.04%	$47,442,829

MTRFA: Pattern of Unfunded Accrued Liability Changes 1997-2004

Source of Actuarial (Gain) or Loss	1997	1998	1999	2000	2001	2002	2003	2004
Salary Increase	9,263,000	(591,000)	14,753,000	7,869,000	(12,689,000)	(17,097,000)	(15,735,000)	--
Investment Performance	(3,227,000)	(53,220,000)	(22,485,000)	37,030,000	13,655,000	71,199,000	99,686,000	94,369,236
Mortality	6,620,000	(281,000)	1,809,000	856,000	848,000	(5,007,000)	(18,966,000)	--
Other (Gains)/Losses	(3,317,000)	3,971,000	3,922,000	21,870,000	17,173,000	8,686,000	6,000,000	9,882,415*
Total (Gain) or Loss	9,339,000	(50,121,000)	(9,845,000)	67,625,000	18,987,000	57,781,000	58,985,000	104,251,651
UAL Change from Plan Amendments	11,482,000	0	0	0	0	(319,000)	0	0
UAL Change from Assumption Changes	12,780,000	0	0	(12,506,000)	0	10,940,000	0	0
UAL Change Due to Insufficient Contributions	24,391,000	7,364,000	7,297,000	6,708,000	12,669,000	14,846,000	24,455,000	32,466,699
Total UAL Change	57,992,000	(42,757,000)	(2,548,000)	61,827,000	31,656,000	83,248,000	83,440,000	136,718,350

* *The 2004 Minneapolis Teachers Retirement Fund Association (MTRFA) actuarial valuation did not allocate the changes in the unfunded actuarial accrued liability of the plan except to categorize the gain or loss as produced as investments or as demographics. The total demographic gain or loss is indicated under the "other items" category.*

Discussion and Analysis

S.F. 1519 (Pogemiller); H.F. 1615 (Smith) attempts to resolve the Minneapolis Teachers Retirement Fund Association (MTRFA) funding problem by authorizing Special School District No. 1, Minneapolis, to issue an unspecified amount of pension obligation bonds, with the bond proceeds deposited with the State Board of Investment, consolidates the MTRFA Coordinated Program into the Teachers Retirement Association (TRA), transfers coverage for MTRFA active members to TRA, sets TRA member and employer contributions by or on behalf of Minneapolis teachers at five percent each, rededicates some Minneapolis Employees Retirement Fund (MERF) state aid to MTRFA, makes certain Minneapolis city and school district voluntary contributions to MTRFA mandatory, sets a five percent maximum on MTRFA post-retirement adjustments, eliminates a minimum investment performance condition on additional amortization state aid to MTRFA and the St. Paul Teachers Retirement Fund Association (SPTRFA), resets the MTRFA amortization target date to 2030, provides job, salary, and employment benefit protections for MTRFA employees, and repeals the current MTRFA investment-related post-retirement adjustment mechanism.

S.F. 1519 (Pogemiller); H.F. 1615 (Smith) raises several pension and related public policy issues that may merit Commission consideration, as follows:

1. Appropriateness of Bonding for the MTRFA Unfunded Actuarial Accrued Liability. The policy issue is the appropriateness of the Special School District No. 1, Minneapolis, issuing pension obligation bonds for the unfunded actuarial accrued liability of the Minneapolis Teachers Retirement Fund Association (MTRFA). The amount of potential bonds is not specified, but is capped at the June 30, 2004, unfunded actuarial accrued liability amount, or $851,787,350. Pension obligation bonds have been used as a financing tool in other jurisdictions and have been used sparingly in Minnesota (in Minneapolis and in Luverne). The issuance of pension obligation bonds has both advantages and disadvantages. Pension obligation bonds are advantageous because the bonds can be issued at an interest rate lower than the interest rate used to calculate the actuarial accrued liability of the pension plan, producing a potential savings that may even be front-loaded. Pension obligation

bonds also have an arbitrage potential, where the investment earnings on the bond proceeds can exceed the issuance rate and can produce a savings. Also, pension obligation bonds can provide budget relief by converting regular pension plan contributions from an annual cost to long-term debt and can provide a different (i.e., longer) amortization schedule than permitted by the pension plan. The identified disadvantages of pension obligation bonds include the shift to the poor fiscal policy of increasing long-term dept to avoid annual operating expenses, the replacement of the soft liability of an unfunded actuarial accrued liability and its flexible payment schedule by a hard liability and a fixed payment schedule, pension obligation bond proceeds may not produce expected investment return or even produce a negative investment return, pension obligation bonds are almost always taxable, generally are non-callable, and are generally expensive to refund, redeem, or defense, and the issuance of pension obligation bonds can have a negative impact on the government's credit rating. In some projections of future pension funding apparently prepared on behalf of MTRFA, attached, $260 million in pension obligation bonds are included. Because of the general fiscal difficulties of the Minneapolis School District currently, the district presumably has a bond rating that is less than stellar and the addition of $260 million in bonds will put further pressure on that rating. The Commission should consider taking some testimony from MTRFA and Special School District No. 1 officials on their views of the risks and advantages of pension obligation bonding. The bonding is clearly expected to be funded from state money and certain state guarantees are specified. The Department of Finance should be asked to share its views on the substance and process proposed for these bonds.

2. <u>Appropriateness of Depositing the Bond Proceeds with the State Board of Investment</u>. The policy issue is the appropriateness of requiring the deposit of the proceeds of the proposed Special School District No. 1/Minneapolis Teachers Retirement Fund Association (MTRFA) pension obligation bond issue with the State Board of Investment, both in general and specifically with respect to the lack of any designation of the State Board of Investment investment program for the MTRFA assets or of a mechanism for handling investment policy changes. Since its creation in 1910, MTRFA has had investment authority separate from the State Board of Investment. Its investment performance long term is unclear. The calculation of time-weighted total rate of investment performance results by MTRFA only began in the mid-1980s and was only regularly reported in 1990. Over the period 1990-2004, for which performance numbers are available, MTRFA has underperformed the State Board of Investment two-thirds of the time (overperformed in 1991, 1992, 1993, 1994, and 1999; underperformed in 1990, 1995, 1996, 1997, 1998, 2000, 2001, 2002, 2003, and 2004). While the State Board of Investment has been an average or slightly below average investment performer, the inability of MTRFA to outperform the State Board of Investment with any regularity would argue for the proposed dedication in general and further raises the question of the appropriateness of continuing to retain MTRFA as the investment authority for any MTRFA assets.
<u>Amendment LCPR05-131</u> would require the investment of all MTRFA assets by the State Board of Investment in the Combined Investment Funds mechanism. Page 2, lines 14 to 17, and page 3, lines 6 to 14, of the bill require the bond proceeds to be invested by the State Board of Investment, without any specificity as to how that authority is to be implemented. The authority could be utilized in two ways, either by utilizing the Minnesota Supplemental Investment Fund, akin to a family of mutual funds, where the portfolio composition choice would be that of the MTRFA Board, or by utilizing the Minnesota Combined Investment Funds, where the portfolio composition would replicate the investment portfolio of the various statewide retirement plans. Under the Minnesota Combined Investment Funds approach, where only a portion of the total current MTRFA assets would be so invested, the portfolio may not have sufficient diversification in its total portfolio mix.
<u>Amendment LCPR05-132</u> would clarify that the investment authority to be given to the State Board of Investment under the proposed legislation would be through the Minnesota Supplemental Investment Fund. <u>Amendment LCPR05-133</u> would have the MTRFA bond proceeds invested through the Minnesota Combined Investment Funds.

3. <u>Appropriateness of Not Considering MTRFA Pension Obligation Bond Proceeds as MTRFA Assets</u>. The policy issue is the appropriateness of excepting the proceeds of the pension obligation bonding for the Minneapolis Teachers Retirement Fund Association (MTRFA) from consideration as MTRFA assets for actuarial and annual financial reporting purposes and their treatment as contribution receipts when used to pay benefits and pension fund administrative expenses. The exclusion of these assets from consideration as MTRFA assets would make sense if the current MTRFA post-retirement adjustment mechanism were to be retained, instead of repealed as proposed in the bill, because the likely improved investment performance from utilizing the State Board of Investment would immediately translate into additional post-retirement adjustment increase amounts. With the current MTRFA post-retirement adjustment mechanism proposed for elimination, it is unclear that the provision serves any good policy purpose. The proponents of the

proposed legislation should be asked to explain the practical or policy advantages they see of this part of the proposal.

4. Appropriateness of the Proposed Consolidation of MTRFA Coordinated Program Retirees and All MTRFA Active Members. The policy issue is the appropriateness of transferring the retirees of the Coordinated Program of the Minneapolis Teachers Retirement Fund Association (MTRFA) and the current active MTRFA members to the Teachers Retirement Association (TRA). The proposed transfer would represent 7.84 percent of the MTRFA retirees and 100 percent of the MTRFA active members. From the MTRFA website summary of the proposed legislation, the bill appears to exceed the intent, which was to transfer only the MTRFA Coordinated Program active members rather than all active members. Amendment LCPR05-258 clarifies that the redefinition of "teacher" in TRA law is restricted to post-June 30, 1978, Minneapolis teachers, the Coordinated Program members. While the MTRFA Coordinated Program essentially replicates the TRA Coordinated Program, which would make the administration somewhat less onerous, TRA would still be obligated to administer the current MTRFA Coordinated Program governing law, bylaws, and articles of incorporation under the proposed legislation. If that similarity is the basis for the proposed transfer/consolidation, the advantages growing out of that similarity may be overstated. If the consolidation is limited primarily to the MTRFA Coordinated Program because of some sense of duty or allegiance between the MTRFA Board and the Basic Program retirees, the proponents should be asked to explain the policy advantages of dividing the Minneapolis school population in this manner.

5. Adequacy of the Asset Transfer Proposed to Accompany the Partial MTRFA Consolidation into TRA. The policy issue is the adequacy of the amount of assets proposed to be transferred from the Minneapolis Teachers Retirement Fund Association (MTRFA) to the Teachers Retirement Association (TRA) to accompany the transfer of retirement coverage for current MTRFA Coordinated Program retirees and current MTRFA active members. The proposed legislation appears to transfer assets equal to the amount determined by applying the funded ratio of the TRA retired member participation in the Minnesota Post Retirement Investment Fund to the required reserves of the MTRFA Coordinated Program annuitants. The Minnesota Post Retirement Investment Fund was 81.66 percent funded on July 1, 2004, and is likely to be somewhat better funded on June 30, 2005, the date driving the asset transfer. The provision is less than a technically clear indication of the assets transfer amount determination procedure and additionally suffers from other limitations and problems, principally the question of how many MTRFA Coordinated Program benefit recipients are included in the term "annuitant." Amendment LCPR05-134 attempts to clarify the asset transfer amount determination language. Amendment LCPR05-135 defines the MTRFA Coordinated Program annuitant group to include age and service retirees, joint annuitants of those retirees, and disabilitants.

6. Uncertainty About Asset Transfer in Cash or in Securities. The policy issue is the appropriateness of the lack of certainty about whether the transfer of assets accompanying the consolidation of the Minneapolis Teachers Retirement Fund Association (MTRFA) Coordinated Program into the Teachers Retirement Fund Association (TRA). If the transfer is made in cash, which is the preferred manner for making an asset transfer, the transfer may necessitate a forced sale of MTRFA assets that could produce additional losses for the plan. If the transfer is made in securities and the State Board of Investment is permitted to choose the securities to be transferred, the securities would better mesh with the other TRA assets invested by the State Board of Investment, but likely would leave the remaining MTRFA investment portfolio unbalanced and poorly diversified, thereby requiring potential forced losses on the remaining MTRFA fund if it attempts to rebalance and rediversify. If the transfer is made in securities selected by the MTRFA, the actual value of the investments could be in dispute where real estate, venture capital, or similar alternative investments are involved and where valuations occur without a regular third-party market.

7. Appropriateness of Rededicating Portions of the MERF State Aid. The policy issue is the appropriateness of dedicating to the Minneapolis Teachers Retirement Fund Association (MTRFA) some or all of the Fiscal Year 2004 – Fiscal Year 2005 state aid payable to the Minneapolis Employees Retirement Fund (MERF). Although the proposed legislation specifies only the Fiscal Year 2004 – Fiscal Year 2005 MERF state aid, which has already been expended or canceled back to the State General Fund, the intent is likely to be the ongoing state aid to MERF under Minnesota Statutes, Section 422A.101, Subdivision 3. The state aid to MERF is based on the actuarial requirements of MERF, not to exceed $9 million annually. In recent years, the largest state aid amount to MERF has been about $6.5 million. The MERF state aid will potentially continue until 2023, if there are still any active members of MERF at that date. MERF was closed to new

employees in 1978. The MERF state aid, if re-dedicated to MTRFA in part or in whole, would increase the state expense to the full $9 million limit, with an increasing portion of that state aid payable to MTRFA until 2023. Amendment LCPR05-136 would recast the provision as an ongoing rededication for current or future state MERF aid rather than limiting it to the 2003-2004 MERF state aid. Amendment LCPR05-137 would limit the portion of the MERF state aid payable to MERF based on its actuarial requirements and the Fiscal Year 2005 MERF state aid figure.

8. Appropriateness of Making Voluntary Minneapolis City and Minneapolis School District/State Aid-Matched Additional Contributions Mandatory. The policy issue is the appropriateness of converting certain City of Minneapolis or Minneapolis Public School contributions, which are matched by state aid, from voluntary contributions to mandatory contributions. The contributions involved are a result of 1993 legislation, where the state matches additional contributions from the City of Minneapolis and the Minneapolis School District dollar-for-dollar, up to $2.5 million annually. The choice of the 1993 Legislature was to have the additional contributions be voluntary. Although the Minneapolis School District did not reach the $1.25 million additional contribution level until 1995 and the City of Minneapolis did not reach the $1.25 million additional contribution level until 1998, both local governmental units appear now to make the full voluntary contribution and, unless the city or the school district have a change of heart in the future, a provision making the contributions mandatory appears to be unnecessary.

9. Appropriateness of the Proposed Split in the Additional MTRFA Basic Program Funding Requirement. The policy issue is the appropriateness of the one-third, one-third, one-third split proposed for the new additional funding requirement for the remaining Minneapolis Teachers Retirement Fund Association (MTRFA) Basic Program between the City of Minneapolis, the Minneapolis School District, and the State of Minnesota. When the MTRFA Basic Program in the future is on the verge of a benefit default after the transfer of the MTRFA Coordinated Program, the new funding requirement requires the MTRFA Board to certify the amount of benefits and administrative expenses for the following year to the Commissioner of Finance, with one-third of that amount payable annually under an open appropriation from the State General Fund, with one-third of that amount dedicated by the Finance Commissioner from any local government aid payable to the City of Minneapolis, and with one-third of that amount deducted by the Finance Commissioner from any state education aid payable to the Minneapolis Public Schools. Under the attached set of funding projections, assuming no bond issuance, the additional funding requirement could become operational as early as 2011. The allocation presumably reflects some notion of the relative proportion of responsibility to be borne by each entity for the current MTRFA funding problem. No portion of the burden is apparently to be borne by the MTRFA membership, although much of the current funding difficulties can be attributed to past benefit increase requests forwarded by the membership and to past investment underperformance resulting from the member-dominated MTRFA Board. The City of Minneapolis has not had any direct responsibility for the Minneapolis Public Schools since the school district was established as a separate legal entity in 1959, has not had any role in setting the benefits or the funding of the MTRFA since 1975, and can contend with some justification that it is not responsible for the post-1975 actions and circumstances that produce the increasingly problematic MTRFA funding situation. The Minneapolis Public Schools employs the bulk of the MTRFA active members, but only has one member of the MTRFA Board and has not been responsible for approving MTRFA benefit increases since 1975 or directing MTRFA administrative or investment activities, so the school district can contend with some justification that it should not bear the cost of benefit promises and administrative and investment misdeeds that caused the current MTRFA funding problem. The State of Minnesota, through the Minnesota State Colleges and Universities System (MnSCU), employs only a small number of MTRFA active members, has no representation on the MTRFA Board of Trustees, and has only granted benefit increases to MTRFA which are similar or identical to those granted to other teacher retirement plans and which were requested by MTRFA, so it is unclear why the State should bear any significant burden of funding the current dire financial condition of MTRFA.

10. Appropriateness of Funding MTRFA by Local Government Aid and General Education Aid Deductions. The policy issue is the appropriateness of providing the additional funding to MTRFA by way of mandated deductions on one-third of the variable current disbursements (i.e., pay-as-you-go) requirement from local government aid for the City of Minneapolis and from state education aid for the Minneapolis School District, respectively. The funding requirements are likely to be highly variable from year to year because the requirement only kicks in when MTRFA has essentially exhausted its assets, including the proceeds of any pension obligation bond sale, and will be driven by the amount of the retirement annuities payable, less any regular funding expected to be received and any investment income obtained on whatever MTRFA assets may exist. Under the future cash

flow projections supplied by the retirement plan, the pay-as-you-go funding requirement would vary from $16 million to $102 million without any bond sale or would vary from $1 million to $122 million with a bond sale. The state aid deduction process, involving variable amounts year to year, could consume a large portion or all of the potential aid to the two units of government, for purposes of retirement funding, which deduction may jeopardize the main function of the governmental unit. It does address the MTRFA funding problem, but may do so at the cost of significant harm to one governmental unit or both governmental units. It is unclear how the City of Minneapolis or the Special School District No. 1 will accommodate drastic changes year to year in the amount of state aid that would be payable. Since both entities have property taxes as their remainder funding source, and property taxes have a year-long lead time for adjusting tax levies, the additional funding requirement will likely be very chaotic for each governmental entity over time.

11. Appropriateness of Dropping Investment Performance as a Condition for Receipt of the 1996 Additional Amortization Aid by MTRFA. The policy issue is the appropriateness of removing from a current Minneapolis Teachers Retirement Fund Association (MTRFA) state aid program, under which the MTRFA became a recipient of a portion of additional amortization state aid in 1996, a requirement that the MTRFA investment performance results equal or exceed the results obtainable from a passively invested (i.e., index funds) debt security-heavy portfolio. The bill proposes eliminating any minimum investment performance requirement for both MTRFA and the St. Paul Teachers Retirement Fund Association (SPTRFA) for an indexed portfolio mix 60 percent debt securities, 30 percent equity securities, and 10 percent cash equivalents. With the approach of MTRFA to default, and the situation of minimum fund assets that may exist from time to time, invested heavily on a cash equivalent basis, the change may be appropriate for MTRFA. The rationale justifying the change for St. Paul Teachers Retirement Fund Association (SPTRFA) is unclear. Amendment LCPR05-138 would eliminate the proposed change for SPTRFA.

12. Appropriateness of Extending the MTRFA Full Funding Date to 2030. The policy issue is the appropriateness of extending the full funding amortization target date for the Minneapolis Teachers Retirement Fund Association (MTRFA) to 2030 from the current 2020 amortization date. The proposed change would reduce the total actuarial requirements modestly, but would not alleviate the fiscal difficulties of the retirement fund. Sound actuarial funding policy aims to fully fund the actuarial liability for promised retirement annuities during the working lifetime of the retirement plan members. The attached future cash flow projections supplied by MTRFA suggest that all MTRFA Basic Program members will retire in 2009 or shortly thereafter, ten years before the current full funding target date and twenty years before the proposed full funding target date. Thus, the proposed amortization date revision is not very consistent with sound retirement funding policy.

13. Appropriateness of Proposed MTRFA Administrative Staff Protections. The policy issue is the appropriateness of the employment, salary, and benefit protections proposed for the administrative staff of the Minneapolis Teachers Retirement Fund Association (MTRFA). The provision mandates that no MTRFA employee will suffer a job loss, have a salary reduction, or have an employment benefit reduction as a result of the consolidation of the MTRFA Coordinated Program with the Teachers Retirement Association (TRA), although the provision indicates that post-July 1, 2009, actions are not to be considered a result of the MTRFA reorganization. The current MTRFA administrative staff consists of eight employees, for a retirement plan covering 13,465 (37.68 percent active members, 27.95 percent benefit recipients; 9.23 percent deferred members, and 25.13 percent non-vested inactive members). The proposed legislation would transfer at least 5,369 MTRFA members (5,074 active members and 295 retirees) to TRA, leaving MTRFA with 3,469 benefit recipients, most of the 1,243 deferred retirees, and many of the 3,384 non-vested inactive members. Although the MTRFA membership would be reduced by at least 40 percent, the administrative staff protection provision would prohibit any consequent staffing reorganization for at least four years. Without many assets, the MTRFA employees connected with the investment function will have little rationale for their continued employment. Without any active members, the benefit counselor positions also would have few or no duties.

14. Appropriateness of the Repeal of the MTRFA Post-Retirement Adjustment Mechanism. The policy issue is the appropriateness of the proposed repeal of the current Minneapolis Teachers Retirement Fund Association (MTRFA) post-retirement adjustment mechanism and the other post-retirement adjustment references in the proposed legislation. The proposal has three post-retirement adjustment related provisions, a repeal of the current MTRFA post-retirement adjustment mechanism (Section 16), the imposition of a five percent annual cap on future MTRFA Basic Program post-retirement adjustments (Section 10, Paragraph (c)), and the specification that former MTRFA Coordinated Program retirees would be covered by the Minnesota Post Retirement Investment Fund statewide

retirement plan post-retirement adjustment mechanism and the indexation of post-retirement adjustments for "other benefit recipients of the former MTRFA" to the Minnesota Post Retirement Investment Fund. There is clarity in the proposal with respect to the future post-retirement adjustments for the MTRFA Coordinated Program members transferred to the Teachers Retirement Association (TRA), but there is no clarity with respect to the MTRFA Basic Program post-retirement adjustment mechanism, with the repeal of the current mechanism constituting a potential benefit take-away, with the five percent post-retirement adjustment cap for MTRFA Basic Program retirees constituting a potential benefit limitation or take-away, and with the attempted indexation of post-retirement adjustments for "other benefit recipients of the former MTRFA" either covering the situation of former MTRFA Coordinated Program disability and survivor benefit recipients only, who would not be directly covered by the Minnesota Post Retirement Investment Fund, or attempting to replace the current MTRFA post-retirement adjustment mechanism for the MTRFA Basic Program with an indexation to the Minnesota Post Retirement Investment Fund. If the current ambiguous provisions are interpreted to index MTRFA Basic Program retirees to the Minnesota Post Retirement Investment Fund, the drafted provision could provide MTRFA Basic Program retirees with a two percent greater post-retirement adjustment than TRA retirees, because the proposed repeal would not affect the current MTRFA automatic two percent post-retirement adjustment, an MTRFA articles of incorporation benefit provision referenced, but not contained, in the MTRFA investment-related post-retirement adjustment provision proposed for repeal, so indexation to the Minnesota Post Retirement Investment Fund could be interpreted as being in addition to that two percent automatic adjustment. Amendment LCPR05-139 would clarify the application of the Minnesota Post Retirement Investment Fund to former MTRFA Coordinated Program members. Amendment LCPR05-140 would clarify the replacement of the current MTRFA post-retirement adjustment mechanism with an indexation to the Minnesota Post Retirement Investment Fund adjustment for MTRFA Basic Program retirees.

15. Resulting Financial and Actuarial Impact of the Proposed Legislation on MTRFA and TRA. The policy issue is the question of how beneficial the impact of the proposed legislation will be for the Minneapolis Teachers Retirement Fund Association (MTRFA) and how adverse the impact of the proposed legislation will be for the Teachers Retirement Association (TRA). The attached cash flow projections prepared by or on behalf of MTRFA indicate the financial impact on MTRFA under various scenarios, but no actuarial impact assessment has been provided by the plan. The proposed legislation will eliminate the chance that MTRFA will default in the payment of future benefits, by virtue of the imposition of additional fail-safe funding requirements on the City of Minneapolis, the Minneapolis Public Schools, and the State of Minnesota. The proposed legislation will transfer more liabilities to TRA than it transfers assets, reflecting at least the current underfunding in the Minnesota Post Retirement Investment Fund (MPRIF) and apparently omitting any asset transfer for the accrued liabilities of active MTRFA Coordinated Program members, deferred members, and non-vested inactives, but no actuarial estimate of that impact has been provided by MTRFA or TRA.

Technical Amendment

Amendment LCPR05-130 attempts to clarify the language and style of the proposed legislation and is intended to function as an author's amendment.

Section-by-Section Summary of S.F. 1519 (Pogemiller); H.F. 1615 (Smith)

Section 1 (New Section 128D.18) authorizes Special School District No. 1, Minneapolis, to issue an unspecified amount of 30-year pension obligation bonds, payable form various state aid amounts and other revenue sources, with the proceeds of the bonds paid to the State Board of Investment to be held in trust for the Minneapolis Teachers Retirement Fund Association (MTRFA). The State of Minnesota pledges that it will not impair the rights of the Minneapolis Public Schools to fulfill the agreements with bondholders. The Minneapolis school superintendent is obligated to certify the annual principal and interest bond costs annually to the Governor. The Legislature is directed to consider a separate biennial line item budget amount for certified amounts.

Section 2 (Amendment to Section 354.05, Subdivision 2) includes all active teachers of Special School District No. 1, Minneapolis, and all coordinated member employees of the Minneapolis Teachers Retirement Fund Association (MTRFA) in the definition of "teacher" for Teachers Retirement Association (TRA) membership.

Section 3 (Amendment to Section 354.05, Subdivision 13) adds pre-July 1, 2005, teaching service by former Coordinated Program active members of the Minneapolis Teachers Retirement Fund Association (MTRFA) as allowable service credit under the Teachers Retirement Association (TRA) benefit plan.

Section 4 (Amendment to Section 354.42, Subdivision 2) specifies that the member contribution to the Teachers Retirement Association (TRA) by former Coordinated Program active members of the Minneapolis Teachers Retirement Fund Association (MTRFA) is five percent of covered pay.

Section 5 (Amendment to Section 354.42, Subdivision 3) specifies that the employer contribution to the Teachers Retirement Association (TRA) on behalf of former Coordinated Program active members of the Minneapolis Teachers Retirement Fund Association (MTRFA) is five percent of covered pay.

Section 6 (New Section 354.70) consolidates the Coordinated Program of the Minneapolis Teachers Retirement Fund Association (MTRFA) into the Teachers Retirement Association (TRA), with a service credit and benefit liability transfer, a records transfer, and a transfer of assets equal to the actuarial accrued liability of the annuitants of the MTRFA Coordinated Program. The benefits of former MTRFA Coordinated Program deferred, inactive, disabled, and retired members and their survivors are required to be calculated under the MTRFA benefit plan in effect on the date of the termination of active Minneapolis service and paid by TRA, with post-retirement adjustments under the Minnesota Post Retirement Investment Fund (MPRIF).

Section 7 (New Section 354.75) rededicates annually to the Minneapolis Teachers Retirement Fund Association (MTRFA) Basic Program any portion of the 2003 state appropriation to the Minneapolis Employees Retirement Fund (MERF) that is unspent.

Section 8 (Amendment to Section 354A.12, Subdivision 3b) makes mandatory the permissive Minneapolis City and Minneapolis School District additional employer contributions, which are matched by a state aid appropriation up to $2.5 million.

Section 10 (Amendment to Section 354A.23) applies after the Minneapolis Teachers Retirement Fund Association (MTRFA) reaches the point of a benefit default and requires the MTRFA Board to annually certify to the Finance Commissioner its estimate of benefit payments and administrative expenses for the following year, with the payment of that amount one-third in a deduction from local government aid otherwise payable to the City of Minneapolis, one-third in a deduction from state education aid to the Minneapolis Public Schools, and one-third payable from the State General Fund. Post-retirement increases to retired MTRFA Basic Program members also are limited to five percent annually.

Section 11 (Amendment to Section 423A.02, Subdivision 1b) eliminates the minimum time-weighted total rate of return investment performance condition for the receipt of a portion of additional amortization state aid for the Minneapolis Teachers Retirement Fund Association (MTRFA) and the St. Paul Teachers Retirement Fund Association (SPTRFA). The threshold performance rate is the performance available using index funds for a portfolio invested ten percent in cash equivalents, 60 percent debt securities, and 30 percent domestic equity securities.

Section 12 (Uncoded Section) makes the Minneapolis Public Schools the successor recipient to the Minneapolis Teachers Retirement Fund Association (MTRFA) for the former MTRFA state aids intended to support the pension obligation bonds in Section 1 and limits the district's power to expand the redesignated aid to pay the debt service on those bonds.

Section 13 (Uncoded Section) resets the amortization target date for the Minneapolis Teachers Retirement Fund Association (MTRFA) as 2030.

Section 14 (Uncoded Section) provides that no employee of the Minneapolis Teachers Retirement Fund Association (MTRFA) may lose that employment, have their salary reduced, or have any employment benefit reduced as a result of the MTRFA reorganization. No action after July 1, 2009, is to be considered a result of the MTRFA reorganization.

Section 15 (Uncoded Section) requires the Revisor of Statutes to replace references to the Minneapolis Teachers Retirement Fund Association Coordinated Program" or propose corrective legislation for the 2006 Legislature.

Section 16 (Repealer) repeals the Minneapolis Teachers Retirement Fund Association (MTRFA) post-retirement adjustment mechanism.

Section 17 (Effective Date) makes the proposed legislation effective either on the date of enactment or July 1, 2005.

Attachment A

Background Information on the Minneapolis Teachers Retirement Fund Association (MTRFA) Establishment and Operation

The Minneapolis Teachers Retirement Fund Association (MTRFA) was created in 1909 by the teaching body of the Minneapolis public schools with the consent of the city council and was incorporated on September 17, 1909. The plan primarily covers teachers employed by Special School District No. 1, Minneapolis, but also includes some faculty members employed by the Minnesota State Colleges and Universities System (MnSCU). Teachers employed by charter schools located in Minneapolis previously were members of MTRFA, but were made members of the Teachers Retirement Association (TRA) in 2002.

In 1924, the Minneapolis teachers' pension plan was restructured to address major pension funding problems that arose during its initial 15 years of operations. In 1952, the pension benefit plan changed from a defined contribution plan to a defined benefit plan. The school district, as a legal entity separate from the city, was established in 1953. In 1967, state aid for teacher retirement plans was enacted when Minnesota enacted a sales tax and the Minneapolis teachers' pension plan received state aid equivalent to the funding provided to the statewide TRA, first as a dollar amount per active member and then as an identical percentage of covered pay, factoring in Social Security contributions for post-1959 TRA members. After 1967, the local property tax levy otherwise to be certified for the Minneapolis teachers pension plan was reduced by the amount of the state teacher retirement aid. In 1975, as part of a property tax relief effort initiated by Speaker of the House, Martin O. Sabo, the local property tax levy authority was eliminated, a pending benefit improvement was delayed, future benefit changes were required to obtain legislative approval rather than local approval, and the employer contribution to MTRFA was set based on a percentage of covered payroll.

The MTRFA coordinated plan, for teachers with Social Security coverage, was created for new members hired after July 1, 1978, and any existing members who elected the plan. Before 1978, MTRFA was a "basic" program, meaning that its members had retirement coverage solely by the local retirement plan and without Social Security coverage by virtue of the Minneapolis teaching service. A Social Security referendum was conducted in 1978 for MTRFA basic program members who desired Social Security coverage to elect to have Social Security coverage, to be supplemented by the MTRFA "coordinated" program. The MTRFA coordinated program substantially replicated the coordinated program of the TRA. All newly hired Minneapolis teachers after July 1, 1978, automatically were covered by Social Security and the MTRFA coordinated program. In 1985, the state funding was converted to a categorical education aid to the school district. The direct payment of employer contributions by the state was replaced by employer contributions from the school district. In 1987, the categorical teacher retirement and Social Security aid was folded into the general education aid program and the basic State funding for teacher retirement and Social Security coverage currently is incorporated into the general state aid to school districts.

MTRFA requested benefit increases that were approved by the Legislature in 1979, 1985, 1986, 1987, 1989 and 1997. MTRFA requested additional State funding and special state aid programs were created in 1993, 1996, and 1997. In 1993, a supplemental $2.5 million annual state contribution to the MTRFA was enacted, to match additional contributions by Special School District No. 1 and by the City of Minneapolis. In 1996, some state funding previously paid to local police and paid firefighter relief associations was redirected to MTRFA if Special School District No. 1 and the City of Minneapolis make additional contributions to MTRFA ($1 million each in 2003 and thereafter). In 1997, an additional annual state contribution to MTRFA was also enacted, which provided $13.3 million in 2003.

The MTRFA is managed by a governing board of seven members, of which six are elected by the members of the association and one is a member of Special School District No. 1, appointed by the school board chair. In addition to maintaining member records and determining benefit amounts, the Minneapolis Teachers Retirement Fund Association governing board is the investment authority for the assets of the retirement fund.

According to its annual financial report and annual actuarial report, in fiscal year 2003, MTRFA received total contributions of slightly over $59.8 million (40 percent from the school district, 27 percent from the state, and 30 percent from the membership), experienced a net investment loss of $110.9 million, paid total retirement benefits of slightly in excess of $110.1 million, and paid administrative expenses of slightly over $800,000 (48 percent for personnel, 15 percent for professional services, and 37 percent for conferences, communications, office rent, and other expenses).

Attachment B

Background Information on the Minneapolis Teachers Retirement Fund Association Funding Problems

The Minneapolis Teachers Retirement Fund Association (MTRFA) is the state's poorest funded teacher retirement fund, with a funding ratio for 2004 of 50.8 percent based on the actuarial value of assets or 44.1 percent based on the market value of assets, and is the Minnesota public pension plan that is the most likely to default in the payment of benefits, with that default likely in the next 10 to 20 years. The plan was 41 percent funded in 1957, was 38 percent funded in 1969, was 46 percent funded in 1972, was 57 percent funded in 1975, when the state first became involved in setting benefits and funding for the plan, was 51 percent funded in 1976, after the Legislature approved the MTRFA benefit increase proposal that was delayed in 1975, was 41 percent funded in 1982, was 54 percent funded in 1992, was 62 percent funded in 2002, and is 51 percent funded in 2004. The unfunded actuarial accrued liability of the plan increased from $457 million in 1998, despite the receipt of significant additional state aid annually, to $852 million in 2004, the annual benefit payout of the plan increased from $67 million to $118 million in 2004, and the contribution shortfall (actuarial requirements in excess of contributions) has grown from $0.9 million in 1998 to $38 million in 2004.

The MTRFA has had funding problems since very early in its history. The plan was restructured in 1924 and was again revised in the 1930s when it was in danger of default. Funding concerns about the plan were being discussed by the MTRFA Board in the 1940s, when Hubert Humphrey was the mayor of Minneapolis and was a member of the MTRFA Board and the school system was part of the city. For most of its history, the plan has had a funded ratio of less than 50 percent (from 1957 to 1972, from 1977 to 1986, and from 1989 to 1990). The plan has only had a contribution sufficiency (total member and employer contributions greater than total actuarial requirements) only twice in its history, in 1974 (sufficiency of 0.82 percent of covered pay, or $0.4 million) and in 1997, as a result of a significant additional state aid program (sufficiency of 0.38 percent of covered pay, or $0.7 million).

The MTRFA funding problems derive from several sources, although the plan representatives point almost solely to the factor of the disallowance of future local property tax levies for the plan from 1975 to 1993. These factors, at a minimum, are the legacy of the plan's historic poor funding practices, the plan's opposition to coordinating with Social Security in the 1950s, 1960s, and 1970s, the plan's addition of a "30 years of service and out" normal retirement age, a pattern of early age retirements, with 35.95 percent of all MTRFA retirees under age 65 in 2004, its 1950s shift to the final average salary base for benefit calculations, its 1976 benefit improvements in the face of diminished contributions, its 1981 creation of a lump sum investment-related post-retirement adjustment mechanism, its 1987 revision of the 1981 post-retirement mechanism into a permanent percentage increase adjustment, and its 1993 further modification in the adjustment mechanism, its 1989 extension of the level benefit accrual rate increase to its "30 years and out" Basic members, large pre-1993 administrative expenses, post-1993 re-designations of administrative expenses as investment expenses not covered by the 1993 excess administrative expense charge, large investment program expenses, including the cost of its significant pre-1999 real estate portfolio, and decades of poor investment performance. The MTRFA funding problems and the process of assessing potential solutions has been complicated by problems within the MTRFA and an apparent lack of interest regarding the problem by Special School District No. 1, Minneapolis. The MTRFA has the legal status of a Minnesota nonprofit corporation, not a pure governmental subdivision, and its board is member dominated (seven of eight board members are MTRFA members, with only one school board representative). The plan historically and properly has viewed its investment role as its most important function, but its pre-1999 significant commitment to equity real estate investment in Minnesota, Texas, and other states, its unsuccessful mid-1980s experiment with portfolio insurance, and its recent significant investment losses raise questions about the value of the plan's investment function. The plan unsuccessfully attempted to sue the State of Minnesota over its funding problems in the late 1980s rather than seek other avenues to address the problem or correct internal structural and operational problems. Special School District No. 1, although it was the sole employing unit covered by the plan until the creation of the Minnesota State Colleges and Universities System (MnSCU) and the creation of charter schools, does not appear to have any overriding sense of responsibility for the plan and has not taken any public role in any legislative deliberations on retirement coverage or funding issues since before 1975.

The Legislative Commission on Pensions and Retirement and the Legislature have attempted to address the Minneapolis Teachers Retirement Fund Association funding issue over the years, first requiring the production of regular actuarial work by or on behalf of the plan in 1965, including the first class city teacher retirement plans in state teacher retirement funding in 1967, when the first state sales tax was enacted, studying first class city teacher retirement coverage issues by the Commission during the 1975-1976 interim, closing the MTRFA Basic Program to new entrants with the 1977 creation of the less costly MTRFA-Coordinated Program, providing increased employer funding in 1978 and 1984, creating a direct state aid program in 1993, studying approaches to a consolidation of teacher retirement plans during the

1993-1994 interim, creating an additional direct state aid program in 1996 and again in 1997, and mandating a study of a restructuring of teacher retirement plans during the 2001-2003 interims. The three direct state aid programs have totaled $127.6 million of funding to MTRFA since 1993, or 168 percent of the plan's 1975 MTRFA unfunded actuarial accrued liability.

If the MTRFA funding problems are to be addressed by the Legislature, the most immediate problem and the most important problem to be solved is the problem of a likely default in the payment of benefits. Although the first class city teacher retirement fund association law has included a provision for a prorated payment of benefits in the event of a default since 1909, any default would be tragic for the plan, the plan membership, Special School District No. 1, and the State. To avert a potential default, at a minimum, the solution must maximize revenue and minimize unnecessary expenditures. Increasing positive investment performance by or on behalf of the plan, reducing any unnecessary administrative or investment expenses, and restructuring the MTRFA post-retirement adjustment mechanism to reduce its adverse funding impact will lengthen the period before a potential default. Beyond those steps, a total solution to the MTRFA funding problem will require additional contributions from some source and the productive investment of that new revenue.

Attachment C

<u>Financial Requirements of and Contribution Levels to the Minneapolis Teachers Retirement Fund Association (MTRFA)</u>

The Minneapolis Teachers Retirement Fund Association (MTRFA) was created in 1910 under state legislation enacted in 1909 (Laws 1909, Chapter 343).

The MTRFA was created in 1910 based on a plan formulated by the teaching body of the Minneapolis public schools and was established after the formulated plan for the collection and disbursement of a fund was approved by the Minneapolis city council and by a majority of Minneapolis teachers, in writing, as evidenced in an affidavit filed by an officer of the Minnesota Board of Education. The formulated plan for the establishment of the MTRFA provided for both member contributions and taxes levied on the property of the city.

The 1909 law provided that the MTRFA officers were to certify annually to the city and county property tax levy authorities the amount of the property tax levy needed to fund the retirement association for the coming year, but without any specificity as to how that amount was to be determined, and with a limit on the levy of one-tenth of one mill on all city taxable property. In 1917 (Laws 1917, Chapter 300, Section 1), the maximum property tax levy for a teachers retirement fund association was increased to two-tenths of one mill for first class cities that were not operating under a home rule charter (i.e. Minneapolis) and retained the one-tenth of one mill limit for other cities of the first class. Minneapolis was authorized to formulate a home rule charter in 1896, but the initial charter proposed in 1898 was defeated, a second (1900) charter was defeated, as were the 1902, 1904, 1906, and 1913 proposed charters. Minneapolis adopted its home rule charter in 1920. In 1919 (Laws 1919, Chapter 144), the maximum property tax levy in cities of the first class without a home rule chapter (Minneapolis) was modified, with authority for the city levy officials to determine that a larger property tax levy was needed, when the levy limit became three-tenths of one mill. In 1921 (Laws 1921, Chapter 303), the city was given explicit authority to approve the teacher retirement levy and three different potential levy limits were established, set at two-tenths of one mill for cities of the first class not operating under a home rule charter (formerly Minneapolis), and at 1.5 mills for cities of the first class operating under a home rule charter that does not fix the amount of tax levies for school purposes (presumably Minneapolis), and set at one-tenth of one mill for all other cities of the first class. In 1923 (Laws 1923, Chapter 310), the 1.5 mill levy limit was extended to all first class cities, whether operating under a home rule charter or not, and the levy limit for other cities was set at one-tenth unless local property tax authorities determined more revenue for the teachers retirement fund association was needed, whereupon the limit was three-tenths of a mill.

In 1935 (Laws 1935, Chapter 111), prior plan amendments of the Minneapolis Teachers Retirement Fund Association (MTRFA) (described as a narrow class rather than specifically named) that had not been subjected to city council approval and any actions based on those plan amendments were validated retroactively, a maximum retirement annuity amount was specified for MTRFA and MTRFA officials were required to file with the clerk of the board of education a statement of assets and liabilities, a statement of receipts and disbursements, and a list of annuities paid. In 1945 (Laws 1945, Chapter 390), in addition to authorizing, with city approval, the “$2.00 bill and annuity” retirement annuity, the prior 1.5 mill limit was eliminated for first class city teacher retirement fund associations in favor of individual home rule charter limitations, and if the teacher retirement fund association certified requirements exceeded the amount actually levied because of a city charter cost of government limitation, the teacher retirement fund association was permitted to record and book those amounts, increase them by the interest rate actually earned by the association, and add them to the amount certified for the following year. In 1949 (Laws 1949, Chapter 523), the retirement annuity maximum was restated. In 1955 (Laws 1955, Chapter 722), the retirement annuity maximum was again revised. In 1957 (Laws 1957, Chapter 655), a separate maximum retirement annuity was specified to accommodate the coordination of the Duluth Teachers Retirement Fund Association (DTRFA) with Social Security.

In 1967 (Extra Session Laws 1967, Chapter 32, Article 3, Sections 2 and 3), as part of the sales tax enactment, the employer obligation to the Teachers Retirement Fund Association (TRA), then 7.00 percent of pay, was removed from the state property tax levy and became an obligation of the property tax relief (sales tax) fund in the state treasury and a state obligation to the first class city teachers retirement fund associations from the property tax relief fund was created, based on the average dollar amount per active TRA member multiplied by the number of active first class city teacher retirement fund associations, but not to exceed the amount that would have been levied as property taxes for the respective retirement associations. In 1969 (Laws 1969, Chapter 399, Section 45), the property tax relief fund was renamed as the general fund. Also in 1969 (Laws 1969, Chapter 485, Section 38), the distribution to the first class city teacher retirement fund associations was reset from the average dollar amount of aid provided per active TRA member to the average percentage of the TRA payroll and was expanded to include Social Security taxes. In 1971 (Laws 1971, Chapter 535, Section 2), the first class city teacher retirement fund association state support obligation was reduced to account for the portion of teacher salaries paid by other than normal school operating funds (primarily Federal funds). In 1974 (Laws 1974, Chapter 213), the manner in which the state support obligation to the Duluth Teachers Retirement Fund Association (DTRFA) was revised to distinguish between the equivalent TRA employer contributions and the equivalent Social Security employer contributions.

In 1975 (Laws 1975, Chapter 306, Sections 30, 31, and 34), the 1909-1974 tax levy limits provision and the 1967-1974 state support obligation provisions were repealed, the state contributions to the first class city teacher retirement fund associations was recodified as Minnesota Statutes, Section 354A.12, future local property tax levies for teacher retirement fund associations were disallowed, future teacher retirement fund association benefit plan amendments were required to receive prior legislative approval, and the Legislative Commission on Pensions and Retirement was required to review the benefit programs of the first class city teacher retirement fund associations as well as the pending Minneapolis Teachers Retirement Fund Association (MTRFA) benefit improvement over the 1975-1976 Interim. The 1975 pending MTRFA benefit improvement was given legislative approval in 1976 (Laws 1976, Chapter 238), when an MTRFA Coordinated Program was created. The implementation of the MTRFA Coordinated Program was delayed until 1978.

Based on the MTRFA annual financial reports on record with the Legislative Commission on Pensions and Retirement, the following sets forth the total annual receipts of the MTRFA from member contributions, local property tax levies, state contributions, and Federal contributions during the period 1954-2004, as characterized by the plan administration:

Year	Member Contributions	Local Property Tax Levies	State Contributions [1]	Federal Contributions
	$	$	$	$
1954	756,571	1,641,626		
1965	1,535,885	1,104,085		
1966	1,689,447	1,160,410		
1967	1,817,909	1,247,724		
1968	2,278,295	2,367,445		
1969	2,680,233	3,166,451	3,434,313	282,630
1970	2,819,489	2,943,538	4,033,873	148,515
1971	3,058,979	3,097,151	4,033,874	0
1972	3,455,306	3,664,558	4,186,727	346,044
1973	3,426,013	3,298,135	4,333,671	574,902
1974	3,632,354	4,566,293	4,673,084	0
1975	3,833,273	5,236,624	2,552,723	736,624
1976	4,399,891	107,399	5,818,980	347,226
1977	5,686,846	25,322	6,750,999	0
1978	5,671,271	592,604	6,949,692	0
1979	5,334,541	5,583	7,037,611	0
1980	5,818,365	8,518	8,371,188	2,053,877
1981	5,788,534	1,043	8,279,942	0
1982	6,150,499	1,263,829	8,755,388	0
1983	7,168,291	0	7,555,297	
1984	7,208,981	634,381	9,939,899	
1985	3,820,557	519,662	5,529,441	
1986	7,464,009	505,881	10,474,658	
1987	7,936,219		12,050,626	
1988	8,311,434		11,968,216	
1989	8,439,553		12,200,600	
1990	8,651,763		12,248,786	
1991	9,336,880		12,357,645	
1992	10,306,800		13,637,820	
1993	10,713,420		13,711,352	
1994	11,507,295	1,224,007	15,131,273	
1995	10,470,386	2,462,276	18,731,951	
1996	11,293,407	2,460,858	20,644,557	
1997	11,696,476	2,481,959	21,539,468	
1998	13,852,469	2,729,486	40,910,813	
1999	14,924,647	3,133,000	37,354,523	
2000	16,168,629	3,435,482	39,121,239	
2001	16,321,023	3,709,563	39,195,363	
2002	17,715,111	3,951,539	38,153,517	
2003	16,672,305	4,290,328	37,896,262	
2004	15,461,562	4,430,146	36,572,938	

[1] After 1986, the financial reports did not designate the source of the regular employer contribution to MTRFA. The state contribution column contains the regular employer contributions since it was paid in whole or in substantial part from state education aid.

Attachment D

Background Information on the Investment Performance of the Minneapolis Teachers Retirement Fund Association (MTRFA)

In Minnesota, statewide retirement plan assets are invested by the State Board of Investment and local retirement plan assets are invested by the governing board of the retirement plan.

The investment performance of the local retirement plans has historically lagged the investment performance of the State Board of Investment, even when the State Board of Investment has had average or below average investment performance. The Minneapolis Teachers Retirement Fund Association (MTRFA) has under-performed the State Board of Investment over the last decade or decade-and-a-half by between one percent and 1.5 percent. The following sets forth the year-by-year time weighted rate of return results for the State Board of Investment and for the major local retirement plans, based on reports filed with the Legislative Commission on Pensions and Retirement (before 2001) or with the Office of the State Auditor (after 2000):

Various Minnesota Public Pension Funds:
Annual Total Portfolio Time-Weighted Rates of Return

Year	SBI Combined Fund	SBI Basic Fund	SBI Post Fund	MTRFA	DTRFA	SPTRFA	MERF
1990		-0.7%	5.0%	-2.5%	3.2%	4.6%	-5.9%
1991		26.3%	19.6%	25.0%	22.0%	19.8%	13.3%
1992		6.8%	8.0%	8.2%	6.5%	7.2%	8.8%
1993		12.2%	11.6%	12.3%	12.8%	11.3%	13.7%
1994	-0.4%			0.1%	0.2%	0.3%	1.2%
1995	25.5%			25.0%	25.5%	26.2%	23.4%
1996	15.3%			13.6%	13.4%	12.6%	12.9%
1997	21.5%			15.5%	15.5%	19.6%	18.5%
1998	16.1%			14.2%	11.1%	12.0%	15.7%
1999	16.5%			21.6%	29.4%	13.6%	15.5%
2000	-2.8%			-6.0%	-1.6%	-0.2%	-1.3%
2001	-6.0%			-7.7%	-4.3%	-1.7%	-6.1%
2002	-11.6%			-16.1%	-12.8%	-9.6%	-11.3%
2003	23.1%			22.8%	28.1%	27.0%	25.2%
2004*	3.9%*			1.8%*		4.2%*	3.4%*

** The 2004 investment returns are partial year returns, through September 30, 2004.*

From 1995 to 2003, the State Board of Investment had higher returns than MTRFA in each year except for 1999. When the investment markets ran into a troubled period from calendar year 2000 through 2002, MTRFA had strongly negative returns, lower in each of those years than any other fund compared in the table.

The average annual investment returns for the period 1990-2003 can be compared, as follows:

Various Minnesota Public Pension Funds:

Annualized (Average) Total Portfolio Returns

Period	SBI*	MTRFA	DTRFA	SPTRFA	MERF
1990-2001	10.3%	9.4%	10.7%	10.1%	8.7%
1990-9/30/03	8.9%	7.7%	n/a	n/a	n/a

** SBI Combined Fund after 12/31/93, and SBI Basic Fund prior to that date.*

If the MTRFA had replicated the investment returns of the State Board of Investment during the period 1990-2003, MTRFA assets would have been more than $100 million greater than the actual 2003 MTRFA asset figure.