Request for City Council Committee Action
From the Finance Department

Date: October 3, 2011
To: Council Member Betsy Hodges, Ways & Mean/Budget Committee
Referral to: City Council

Subject: Redemption of Taxable Pension Bonds

Recommendation: Finance Department recommends passage of a resolution:

1. Authorizing the Finance Officer to call for redemption the General Obligation Taxable Pension Bonds (MERF), Series 2003 on December 1, 2011.
2. Authorizing an appropriation increase of $36,000,000 in 2011 to allow for the bond redemption on December 1, 2011.

Previous Actions:
Taxable Pension Bonds were issued for the 3 closed pension plans, totaling $119 million, as follows:
Minneapolis Employees Retirement Fund (MERF):
Series 2002 for $25,000,000 sold December 11, 2002
Series 2003 for $36,000,000 sold June 25, 2003.
Minneapolis Police Relief Association (MPRA):
Series 2002 for $10,600,000 sold December 11, 2002
Series 2003 for $17,900,000 sold October 30, 2003.
Series 2004 for $24,970,000 sold November 17, 2004.
Minneapolis Fire Relief Association (MFRA):
Series 2004 for $4,740,000 sold November 17, 2004.
November 1, 2006, prepaid all remaining October 2003 MPRA bonds.

Prepared/Submitted by Michael Abeln, Director, Capital & Debt Management, 673-3496

Approved by: Kevin Carpenter, Chief Financial Officer ___________________________

Steven Bosacker, City Coordinator _______________________________

Presenters in Committee: Michael Abeln, Director, Capital & Debt Management

Financial Impact:

- Actions to be taken on December 1, 2011 will reduce the City's outstanding debt by $36,000,000 and save $20,075,300 in future interest charges. On December 1, 2012 the City will have another opportunity to reduce the City's remaining outstanding pension debt by $49,190,000 and save $25,824,657 in future interest charges. These actions will reduce the City's 2013 and beyond financial commitments by a total of $131,089,957, of which $45,899,957 is interest savings. The resources for the 2012 refunding are included in the Mayor's 2012 budget recommendations.

- This action requires an appropriation increase to the 2011 Operating Budget
  Dept Name: 1100100 Debt Service Bonds and Interest
  Fund Name: 05270 Pension Fund Debt Service
  Amount: $36,000,000
- The 2012 bond call appropriation is currently included in the Mayor's 2012 budget.
- Action requires use of funds on deposit in the Pension Management Plan.
- Request provided to the Finance Department.
- Action improves out year financial capacity for direct services & capital needs.

Background:

The City had three closed pension plans that necessitated creation of a long-term financial plan to avoid significant levy increases from 2002 – 2004. The Finance Department refers to the plan as the Pension Management Plan (PMP). The first component deals with MERF and the second revolves around the pension plans for the public safety employees in the police and fire departments that were hired prior to 1980.

MERF

The Minneapolis Employees Retirement Fund includes employees (and former employees) from the City of Minneapolis (including the Park Board and Municipal Building Commission), the Minneapolis school district, the Metropolitan Council, and Hennepin County. The funding problems with MERF began to appear in early 2002. This fund is not a cost sharing fund but rather each employee had an independent account. When an employee retired, their account was emptied and the employer was obligated at that time to transfer 100% of the present value of the member's total lifetime pension from their active account to the retired fund. After this transfer occurred, the six employers' only on-going liability for retired members was limited to an annual mortality adjustment based on experience from the prior year. These adjustments were normally small from a financial perspective and the normal actuarial contributions from the employers and the State's statutory contribution were sufficient to make the required payments.

Over time, based on the composition of the MERF population and the fact that employees were retiring earlier than anticipated and with higher entitlements, employers' obligations began to rise. This was compounded by incentives offered to employees to retire early as a result of reductions in State aid to local governments though 2005. To fund the City's share of payments to MERF, the City issued $61 million of taxable pension bonds in 2002 and 2003. During 2007, legislative actions eliminated the liquidity provisions that were onerous to the City and the remaining liability of the fund was to be paid on a level dollar basis though 2020.

MERF retirees' accounts were not meeting the actuarial assumptions and post fund projections showed the accounts would be unable to meet obligations. Since employers had already met their full statutory obligation the retirees turned to the legislative process to resolve the issue by forcing the employers for the second time to provide funding. The retirees were successful and MERF was consolidated under PERA on June 30, 2010. Legislation extended the full funding date to 2031 and set a minimum annual payment from the employers of $27 million and maximum annual payment of $34 million. This has now all been factored into the PMP.

The $61 million in MERF bonds that were issued are all still outstanding. With funds deposited in the PMP though 2011, the $36 million 2003 bond issue can be redeemed this December saving $20,075,300 in future interest payments. With additional deposits on hand and amounts recommended to the PMP in the Mayor's Recommended 2012 Budget, the remaining $25 million could be called on December 1, 2012 saving an additional $17,400,000 in future interest costs on MERF bonds.

MPRA/MFRA

The second component involves the two closed public safety related pension funds MPRA and MFRA. The impacts of MPRA are significantly larger than MFRA because of the number of retirees, a full funding date of 2020 and a much poorer funding ratio than MFRA. For both of these funds, the City contributes an annual amount based on the number of years left to amortize the unfunded liability of the fund. Actuarial investment assumptions set by the State assume a 6% return with gains & losses smoothed in over a three-year time frame. These two funds' investment performance mirrored the overall market and the dot.com bubble bust at the start of the last decade caused their unfunded liability to soar. The MPRA's unfunded liability rose from $20M on December 31, 1999 to $56M in 2000, $115M in 2001, $153M in 2002 and $165M in 2003. MFRA went from being fully funded with excess assets of $26M on December 31, 1999 to an unfunded liability of $56M in 2003. As a result of the above $53,470,000 of Taxable MPRA Bonds were issued from 2002 to 2004 and $ 4,470,000 of Taxable MFRA Bonds were issued in 2004 to avoid excessive levy increases. In addition, $3.2M of cash on deposit in the PMP was used to reduce what would have otherwise been astronomical tax levy increases during the 2002 to 2006 timeframe. The investment market crash related to the housing bubble would have had a similar effect on the City's levies needed to support these funds going forward from 2012 if not for the consolidation bill passed by the State this past special legislative session.

Recommendation

With the recent legislative action and acceptance by the MPRA and MFRA, the City is finally reaching the point where the major uncertainties involving these three closed pension plans are quantifiable. This is enabling the Finance Department to now recommend taking action to use PMP funds on hand to retire a portion of the existing high cost taxable pension debt and free up out year capacity for other direct services and capital needs.

The Finance Department recommends passage of the attached resolution authorizing the Chief Financial Officer to call in the outstanding General Obligation Taxable Pension Bonds (MERF), Series 2003 on December 1, 2011. This will also require an appropriation increase in the 2011 Debt Service appropriation in (1100100 – 05270 - 851001) by $36,000,000 to allow for the bond redemption payment.