State of Minnesota
Office of the State Auditor

Patricia Anderson
State Auditor

LARGE PUBLIC PENSION PLAN INVESTMENT REPORT

For the Year Ended December 31, 2005

Description of the Office of the State Auditor

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost effectiveness in local governments throughout the state.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice – conducts financial and legal compliance audits for local governments;

Government Information – collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations – provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension Oversight – monitors investment, financial, and actuarial reporting for over 700 public pension funds;

Tax Increment Financing (TIF) – promotes compliance and accountability in local governments' use of TIF through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employee's Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

Office of the State Auditor
525 Park Street, Suite 500
Saint Paul, Minnesota 55103
(651) 296-2551
state.auditor@state.mn.us
www.auditor.state.mn.us

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Large Public Pension Plan Investment Report

For the Year Ended December 31, 2005

December 11, 2006

Pension Division
Office of the State Auditor
State of Minnesota

Pension Division
Jared Jordal, Pension Director
Rose Hennessy Allen *Management Analyst*
Brian Martenson *Management Analyst*
Paul Rosen *Management Analyst*
Gail Richie

Legal Counsel
David Kenney

Auditors
Rick Pietrick, Audit Director
Scott Hemsey
Ryan Koskan
Mike Olsen
Elissa Pfannenstein

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Overview

This report reviews the investment performance of Minnesota's large public pension plans. These pension plans, plus the State Board of Investment, held over $46 billion in assets at the end of 2005 and represent the retirement savings of thousands of public employees. Strong oversight of these pension plans is important to safeguard the pensions of public employees, limit local and state liabilities, and guide fiduciary responsibilities. Ensuring that these pension plans are managed effectively can improve retiree benefits and lower costs to both taxpayers and current public employees.

The seven individual large public pension plans included in this report are: the Bloomington Fire Department Relief Association, the Duluth Teachers' Retirement Fund Association, the Minneapolis Firefighters' Relief Association, the Minneapolis Employees Retirement Fund, the Minneapolis Police Relief Association, the Minneapolis Teachers' Retirement Fund Association, and the St. Paul Teachers' Retirement Fund Association.[1] The State Board of Investment (SBI), which is referenced frequently, is not a pension plan, but invests the assets of certain public employee pension plans. The conclusions and discussion found in this report can also be considered to apply in large degree to the Teachers Retirement Association[2] (TRA), the Public Employees Retirement Association[3] (PERA), and the Minnesota State Retirement System[4] (MSRS), all of which invest their assets through the SBI.

While this is an investment report, the State Auditor's Office audits each of these seven pension plans annually and has broad oversight responsibility for the public pensions of Minnesota. Aside from the employees themselves, public employers and State taxpayers invest tens of millions of dollars each year in these pension plans and have a shared stake in their efficiency and success. This Office is in an ideal position to comment on how contribution and benefit levels, management and investment strategies, and administrative and investment expenses affect the funding ratios of the pension plans and the ongoing attainment of their public policy goals.

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[1] The Minneapolis Teachers' Retirement Fund Association was statutorily dissolved on June 30, 2006, and its members, assets, and liabilities transferred to the Teachers' Retirement Association.

[2] The Teachers Retirement Association (TRA) is one of Minnesota's statewide public pension plans providing retirement, disability and death benefits to Minnesota college faculty, public school teachers, administrators, retirees, and their families. TRA covers all public school teachers outside of Minneapolis, St. Paul and Duluth.

[3] Established in 1931, PERA administers three statewide retirement plans providing defined benefit plan coverage to employees of local governments and school districts, and one statewide retirement plan providing defined contribution (DCP) coverage to elected officials and medical personnel.

[4] The Minnesota State Retirement System (MSRS) administers ten different retirement plans which provide retirement, survivor, and disability benefit coverage for Minnesota state employees as well as employees of the Metropolitan Council and many non-faculty employees at the University of Minnesota. MSRS covers over 50,000 active employees and currently pays monthly benefits to over 20,000 retirees, survivors, and disabled employees.

Understanding Investment Performance Terms

When discussing investment performance there are a few key concepts to understand.

Asset Allocation

Asset allocation describes the practice of distributing a certain percentage of a portfolio between different types of investment assets, such as stocks, bonds, cash, real estate, options, and others. By diversifying an asset base, one hopes to create a favorable risk/reward ratio for a portfolio. All of Minnesota's large public pension plans have chosen to invest a significant portion of their assets in the equity markets (stocks). Stocks have historically had higher returns than investments in debt (bonds) or cash. Within equities there are many sectors, which are usually based on the size of the companies (capitalization), rate of growth, book value compared to market value, or domestic as opposed to international markets.

Active or Passive Investment Strategy

In addition to choosing their asset allocation, investors can choose to actively or passively invest. Passive management is more commonly called indexing. Indexing is an investment management approach based on investing in exactly the same securities, in the same proportions, as an index. The management style is considered passive because portfolio managers do not make decisions about which securities to buy and sell; they simply copy the index by purchasing the same securities included in a particular stock or bond market index. Common indices include the S&P 500 and the Russell 3000. In contrast, active management is simply an attempt to "beat" the market as measured by a particular benchmark or index. The aim of active fund management — after fees are paid — is to outperform the index a particular fund is benchmarked against. Prevailing market trends, the economy, political and other current events, and company-specific factors (such as earnings growth) all affect an active manager's decisions.

Passive investing often has lower costs than active investing. In general, trading fees and research expenses are less. These extra expenses of actively-managed funds can nullify any extra gains an active manager might earn. Some studies[5] have shown that active money managers are not able to beat an index over the long term. This is an ongoing debate in the investment community. The results of the large plans' active management have been mixed, with some plans benefiting from active management and others being hurt by it.

Besides active and passive investing, there is a hybrid strategy that many of the large plans are using called enhanced indexing. The goal is to return the same as an index, plus a half to one percent. The underlying strategies are complex but these investments have become common and are prevalent in the investing world.

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[5] "The Implications of Style Analysis for Mutual Fund Performance Evaluation," Journal of Portfolio Management, [Summer, 1998]. "An Index Fundamentalist Goes Back to the Drawing Board" by John C. Bogle, Journal of Portfolio Management, Spring 2002, Volume 28, Number 3.

2005 Performance Detail

Bloomington Fire Relief Association

Bloomington Fire returned 4.7 percent in 2005, as calculated by our Office. Bloomington Fire calculated its return as 5.1 percent. Both of these are above its benchmark return of 4.2 percent, which consists of 70 percent of the S&P 500 and 30 percent of the Lehman Brothers Aggregate Bond Index. This benchmark does not match what Bloomington Fire invests in, using the Russell 3000 instead of the S&P 500 would be more representative of the plan's portfolio and would result in a benchmark of 5 percent. More than half of the plan's assets are indexed to the Russell 3000.

Bloomington Fire invests more than three-quarters of its assets with the SBI. It holds $70 million in the SBI Income Share Account, and nearly $13 million in the Common Stock Account. The Income Share Account — with a target of 60 percent domestic equity indexed to the Russell 3000, 35 percent fixed income and 5 percent cash — did well, returning 5.0 percent. The Common Stock Account tracks the Russell 3000, and performed as expected. Since the Income Share Account holds 5 percent in cash, Bloomington Fire should consider adjusting its investment policy, which currently has no allocation to cash, to reflect this.

Bloomington Fire held 7 percent of its assets in a balanced account with money manager WCM. The return on this account was only 2 percent during 2005. This account held more than two-thirds of its assets in equity at the end of 2005, making the 2 percent return very disappointing.

The remainder of Bloomington Fire's assets are held and managed internally. This includes individual stocks, bonds, and mutual funds. The largest holding, about one-third of internally managed assets, is in the American Balanced Fund, which returned 3.1 percent in 2005. This fund could be compared to the SBI Income Share Account, which returned 5.0 percent. The total return on the internally managed assets was 2.9 percent.

Duluth Teachers' Retirement Fund Association

Duluth Teachers' investments rebounded strongly in 2005, after slightly underperforming its targets in 2004. Duluth Teachers' total fund return was 7.5 percent, beating its benchmark of 5.6 percent. Strong performance in equities — domestic and international — fueled its excellent investment returns.

Duluth Teachers' investment policy allocates 53 percent of its assets to domestic equities. Over half of this is invested in an enhanced S&P 500 index fund. This fund returned 4.7 percent, below the index return of 4.9 percent. Over the long term, its goal is to return .5 to 1 percent higher than the S&P 500. Duluth Teachers' two other domestic equity funds excelled during 2005. Disciplined Growth Investors (DGI) invests in small-capitalization growth stocks. The index for these investments returned 4.1 percent for 2005, while DGI returned 12.8 percent. Wellington Management Company invests in small and mid-capitalization value stocks. The return of 10.1 percent exceeded the benchmark for these types of investments, which was 7.7 percent.

The total return on Duluth Teachers' domestic equity during 2005 was 8.0 percent, compared to its benchmark of 5.4 percent. Performance was also strong compared to the overall stock market measured by the Russell 3000, which returned 6.1 percent.

Duluth Teachers' investment policy allocates 12 percent of its assets to international equity. At the end of 2005, the plan had almost 17 percent of its assets in the Julius Baer International Equity Strategy Fund. The return on this fund was 16.7 percent for 2005, well above the MSCI EAFE index return of 13.5 percent. Julius Baer may invest a portion of the fund in emerging market and small-capitalization foreign stocks. Emerging market stocks returned 34.0 percent in 2005, so some of the excess return likely resulted from investments in this sector.

Duluth Teachers' investment policy allocates 30 percent of its assets to fixed income investments, managed by Western Asset Management. The plan does not invest in junk bonds, only investment grade bonds, and may hold a small portion of the portfolio in international bonds. The portfolio returned 2.9 percent, while the index returned 2.4 percent in 2005.

Duluth Teachers' allocation to real estate is 2 percent. At the end of 2005, Duluth Teachers' had less than 1 percent of its assets in real estate. The plan receives mortgage payments and rent on buildings it owns, including the building it is housed in. Real estate for Duluth Teachers' returned 11.5 percent in 2005. The NCREIF Property Index returned 20.1 percent, but since Duluth Teachers' holdings are not diversified, it is difficult to compare them to a benchmark.

Duluth Teachers' opened two Real Asset accounts in 2005. Real Asset investments include commodities and real estate. As of the end of 2005, Duluth Teachers' had not updated its investment policy to allocate for Real Assets. The PIMCO account was funded with $8 million in October, and the Wellington account was funded with $5.3 million at the beginning of November. This amounts to around a 5 percent allocation of Duluth Teachers' assets. During the period which Duluth Teachers' was invested in these accounts Wellington returned 7.2 percent and PIMCO returned negative 2.2 percent.

Minneapolis Employees Retirement Fund

MERF's 2005 return was 7.3 percent, just below its benchmark of 7.6 percent. This does not include the Deposit Accumulation Fund (DAF), which returned 1.5 percent, also just below its benchmark of 1.8 percent. The DAF, which holds the active members' assets, only had $39.6 million at the end of 2005, compared to the fund's asset total of $1.3 billion.

Poor performance in domestic equities caused MERF to miss its benchmark return. The biggest detractor was Private Capital Management. The 2005 return on the small and mid-capitalization portfolio was negative 1.3 percent, compared to the Russell 2500 benchmark return of 8.1 percent. MERF's PIMCO StocksPLUS fund, with a goal of outperforming the S&P 500, returned only 4.2 percent in 2005, compared to the S&P 500 return of 4.9 percent. These two funds held 38 percent of MERF's domestic equity, while its State Street Russell 3000 Index Fund held the majority of the plan's domestic equity. State Street performed as expected, returning 6.2 percent. MERF's investment policy allocation to domestic equity is 40 percent.

State Street also holds all of MERF's international equity in an MSCI All Country World excluding U.S. index. This fund also performed as expected, returning 16.4 percent, just below the benchmark of 16.6 percent. MERF's investment policy allocates 15 percent of its total portfolio to international equity.

Differing from international equity by the fact that it holds U.S. equities, MERF's global equities portfolio at Capital Guardian returned 13.3 percent in 2005. This exceeds its benchmark return of 10.8 percent. Around one-third of the portfolio was invested in U.S. securities. MERF's investment policy allocates 10 percent of its total portfolio to global equities.

Three managers hold MERF's fixed income investments. Aberdeen Asset Management held just under one-third of the portfolio, while PIMCO and Western Asset Management each held slightly over one-third. Aberdeen returned 3.1 percent in 2005, exceeding the Lehman Brothers Aggregate Bond Index return of 2.4 percent. PIMCO and Western both invest primarily in inflation-protected securities. Their returns were 3.1 percent and 3.0 percent, respectively. They both exceeded their benchmark return of 2.8 percent. MERF's investment policy allocates 30 percent of its total portfolio to fixed income.

Adelante Capital's Real Estate Investment Trust portfolio returned an excellent 17.1 percent, both in absolute terms and against its benchmark, the Wilshire REIT index, which returned 13.9 percent in 2005. MERF's investment policy allocates 5 percent of its total portfolio to real estate.

Minneapolis Firefighters' Relief Association

Minneapolis Fire returned 6.6 percent in 2005, above its benchmark return of 4.1 percent. While Minneapolis Fire did have a good year in 2005, its benchmark is not a fair measure of the performance; it measures the plan's portfolio against large company stocks, while it invests in various sectors of the stock market including small company stocks.

The 2005 rate of return calculated by Minneapolis Fire's consultant was 5.9 percent, differing significantly from the rate of return of 6.6 percent calculated by the State Auditor's Office from cash flow data provided by Minneapolis Fire. The consultant could not provide a cogent explanation for this difference. The consultant misstated rates of return for Minneapolis Fire's Common Stock and Bond Accounts held at the State Board of Investment. The rates of return calculated by the State Auditor's Office, and verified by the State Board of Investment, were 6.2 percent for the Common Stock Account and 2.8 percent for the Bond Account. The consultant could not adequately explain how it calculated its returns of 4.9 percent and 2.4 percent, respectively.

Accurate rates of return are essential to making informed investment decisions. Minneapolis

Fire moved $25 million out of the State Board of Investment Common Stock Account and $12 million out of the Bond Account during December of 2005. The Common Stock Account is an index fund that had been performing as expected, and the Bond Account had been successfully exceeding its benchmark. It is dismaying to consider that Minneapolis Fire perhaps had incorrect investment return data when it made these changes to its portfolio.

Unlike the other large plans, Minneapolis Fire does not specify target asset allocations in its investment policy, but uses ranges of 40-70 percent in domestic equity, 20-40 percent in domestic bonds, and 0-5 percent in real estate and other.

Minneapolis Fire's four managers that invest solely in domestic equity returned 6.5 percent during 2005. Managers Kayne Anderson Rudnick and Marquee Millennium both added value, while White Pine Capital slightly underperformed its benchmark. Kayne Anderson Rudnick returned 7.8 percent versus a benchmark return of 4.6 percent, Marquee Millennium returned 8.0 percent versus a benchmark return of 7.1 percent, and White Pine Capital returned 3.9 percent versus a benchmark of 4.1 percent. The SBI Common Stock Account, an index fund, performed as expected returning 6.2 percent.

Minneapolis Fire held fixed income accounts at RiverSource and the SBI throughout the year, and a PIMCO account was added in December. RiverSource returned 2.5 percent and the SBI 2.8 percent, both exceeding the Lehman Aggregate Index return of 2.4 percent.

Minneapolis Fire opened two international equity accounts in December of 2005. Over the past eight years, the plan had not been significantly invested in international equity. Just under 10 percent of total fund assets were used to fund these two investments.

Minneapolis Fire also opened a Global Natural Resources account at Ivy Funds. This account invests in natural resources related stocks in the U.S. and abroad. Opened in July, the fund returned 17.5 percent, which is a very strong performance.

Minneapolis Fire had five managers that held balanced accounts (holding both stocks and bonds) at the end of 2005. Alliance Capital was terminated during the year. Alliance Capital had been the star performer for Minneapolis Fire, especially during the late 1990s. Their performance had declined in the recent past.

Balanced accounts at Mairs & Power and Leuthold Weeden were opened in June of 2005. Mairs & Power returned 3.5 percent while it was open, while Leuthold Weeden returned 17.4 percent, driving Minneapolis Fire's total fund return above market returns.

The three other balanced accounts were held with US Bancorp, returning 5.5 percent, Voyageur, returning 3.4 percent, and Alliance Bernstein, returning 6.4 percent.

Minneapolis Police Relief Association

Minneapolis Police returned 6.0 percent in 2005, missing its benchmark return of 6.5 percent. During 2005, Minneapolis Police continued its pattern of turning over investment managers. Three new accounts were opened and one was closed. The new accounts were funded primarily from the Alliance Capital Management Fixed Income account that was closed during 2005 and a reduced allocation to the S&P 500 index fund at Wells Fargo. The three new accounts are with Loomis Sayles (fixed income), PIMCO (enhanced S&P 500 index), and Capital Research and Management (global equities).

Domestic equities returned 4.7 percent. This is well below its benchmark Wilshire 5000 return of 6.4 percent, and below the S&P 500 return of 4.9 percent. Almost three-quarters of Minneapolis Police's domestic equity portfolio is in index funds. Wells Fargo and PIMCO (an enhanced index fund) track the S&P 500, and the SBI tracks the Russell 3000. Wells Fargo and the SBI both performed as expected, while PIMCO lagged its benchmark by 1.3 percent during the 6 months it was open.

Minneapolis Police's actively managed domestic equity added no value in 2005, with the three managers all underperforming their benchmarks. The domestic equity fund held at Grantham, Mayo, Van Otterloo, opened in 2004, continued to perform poorly for Minneapolis Police, returning only 3.2 percent compared to its Wilshire 5000 benchmark of 6.4 percent. So far, this fund has not succeeded in choosing the correct market sectors to invest in. After a successful 2004, Brandywine, a small-capitalization value manager, returned 3.6 percent while its benchmark returned 4.7 percent. Small-capitalization growth manager Wasatch, which under performed its benchmark by 14.2 percent in 2004, again under performed in 2005, returning 3.4 percent versus a benchmark return of 4.1 percent.

Minneapolis Police would have been much better off if it invested its domestic equity in index funds that tracked the overall market. The plan could have returned 6.1 percent in a Russell 3000 index fund, instead of the 4.7 percent that its domestic equity returned.

A global equities fund managed by Capital Research and Management, the New Perspective Fund, was opened during 2005. This fund successfully beat its benchmark, the MSCI All-Country World Index, returning 14.1 percent during the nine months it was open, compared to the benchmark 11.9 percent.

Minneapolis Police's fixed income portfolio performed well in 2005, returning 3.1 percent. Galliard and the SBI Bond Market Account returned 3.3 percent and 2.8 percent respectively, beating the Lehman Brothers Aggregate Bond Index return of 2.4 percent. Western returned just below the benchmark at 2.2 percent. During the six months it was open, the account at Loomis Sayles returned 2.7 percent—above its benchmark and adding value for Minneapolis Police.

Minneapolis Police's international equity portfolio returned 15.1 percent during 2005, below its benchmark of 16.6 percent from the MSCI All-Country World Index ex.U.S. The two international equity managers, Mercator and the SBI, both underperformed relative to their benchmarks. Mercator was the poorer performing fund, returning 12.1 percent versus the MSCI EAFE return of 13.5 percent.

During 2005, Minneapolis Police's investment policy allocated 55 percent of the total fund to domestic equities, 32 percent to fixed income, and 13 percent to international equities. Minneapolis Police's investment policy was updated in 2006 to reflect its allocation to global equities.

Minneapolis Teachers' Retirement Fund Association

Minneapolis Teachers' returned 5.7 percent in 2005, below its benchmark return of 6.2 percent.

During December of 2005, Minneapolis Teachers' closed its actively managed domestic equity accounts and moved the assets into index accounts. This change was long overdue, since its actively managed domestic equity had not been able to keep up with market returns in the past. Over the past nine years its domestic equity returned 5.9 percent, while the overall market returned 7.9 percent. The total return for Minneapolis Teachers' domestic equity in 2005 was 5.8 percent, exceeding market returns considering the sectors of the market Minneapolis Teachers' was invested in. For most of the year, almost two-thirds of its portfolio was indexed to the S&P 500 and performed as expected. Until they were closed in December, active managers Wasatch and GE underperformed their benchmarks, but Alliance Capital more than made up for it — returning 15.4 percent through November, tripling its benchmark, the Russell 1000 Growth. Minneapolis Teachers' investment policy allocates 57 percent of the total fund to domestic equities.

Minneapolis Teachers' fixed income portfolio returned 2.5 percent in 2005, just over the Lehman Brothers Aggregate Index return of 2.4 percent. Minneapolis Teachers' investment policy allocates 25 percent of the total fund to fixed income, of which 60 percent is indexed and the rest actively managed by Blackrock.

International equity underperformed for Minneapolis Teachers' during 2005, returning 12.3 percent, below the MSCI EAFE return of 13.5 percent. Half of the portfolio is indexed, with Templeton actively managing the other half, which returned 11.4 percent in 2005, well below the index. Minneapolis Teachers' allocates 15 percent of the total fund to international equity.

The return on alternative investments was negative 3.8 percent. Minneapolis Teachers' is invested in two venture capital funds run by the RWI Group. It is difficult to value a venture capital fund, making one-year performance not as good of a measuring stick as other investments. The total return after the investment matures (often a number of years) will determine if it was a good investment. Minneapolis Teachers' allocates one percent of the total fund to venture capital.

St. Paul Teachers' Retirement Fund Association

St. Paul Teachers' followed a strong year in 2004 with a total fund return of 9.9 percent in 2005, exceeding its benchmark return of 8.9 percent.

St. Paul Teachers' domestic equity portfolio returned 8.9 percent in 2005. Forty percent of the portfolio is indexed in three funds, which all performed as expected. Six managers hold St. Paul Teachers' remaining domestic equity. All six exceeded their benchmark returns. Two of the better performers were Alliance Capital's large-capitalization growth portfolio, returning 16.3 percent versus its benchmark of 5.3 percent, and Dimensional Fund Advisors' small-capitalization value fund, returning 9.3 percent against its benchmark of 4.7 percent. Active management added over 2.5 percent of value for St. Paul Teachers' domestic equity. St. Paul Teachers' investment policy allocates 45 percent of the total portfolio to domestic equity.

St. Paul Teachers' investment policy allocates 19 percent of the total portfolio to fixed income. Voyageur actively manages about half of St. Paul Teachers' fixed income, while the other half is invested in a Lehman Brothers Government/Credit index portfolio. The actively managed portion returned 3.0 percent, while the indexed portion return equaled its benchmark of 2.4 percent, for a total fixed income return of 2.7 percent for 2005.

St. Paul Teachers' small-capitalization (or emerging markets) international equity portfolio performed well during the year, returning 38.4 percent versus a benchmark of 34.0 percent. Its large-capitalization international equity did not perform as well, dragged down by Morgan Stanley's return of 7.1 percent, compared to the MSCI EAFE benchmark of 13.5 percent. During 2005 an EAFE Plus fund was opened at JP Morgan. St. Paul Teachers' investment policy allocates 21 percent of its total portfolio to large-capitalization international equity, and 4 percent to small-capitalization (emerging market).

St. Paul Teachers' real estate portfolios are held in a fund at UBS and a newly-opened Advantas fund. The UBS fund returned 19.8 percent, just below the benchmark NCREIF return of 20.1 percent. The Advantas fund returned 16.7 percent in 2005. St. Paul Teachers' investment policy allocates 8 percent of its total portfolio to real estate.

The State Auditor's Office calculated a return of 23.3 percent on St. Paul Teachers' alternative assets. These investments include a private equity fund and a private equity investment. These investments are illiquid, therefore accurate values and returns are difficult to ascertain. St. Paul Teachers' allocates 2 percent of its total fund to alternative assets, but only has .5 percent invested.

State Board of Investment

The returns for the State Board of Investment are presented primarily for comparison purposes and because various public pension plans have partial or total investiture through SBI. For 2005, the SBI Basic Fund (active members) returned 10.2 percent, while the Post Fund (retired members) returned 9.6 percent. Both plans beat their benchmarks, which were 10.1 and 9.4

percent, respectively. The benchmarks are calculated in a slightly different manner than other plans' benchmarks. The benchmarks are much higher than those for other plans because the alternative assets benchmark is its actual return, which was very high in 2005.

The Basic and Post Fund assets are invested together in a combined fund. The returns discussed below are for the combined fund. Differences in returns between the Basic and Post Funds result from how the assets are broken up and the differing actual asset allocation of each fund. The policy allocation for both plans is similar, with 45 percent allocated to domestic equities and 15 percent to international equity. The Basic Fund has 24 percent allocated to bonds, 15 percent to alternative assets and 1 percent to cash while the Post Fund has 25 percent allocated to bonds, 12 percent to alternative assets and 3 percent to cash. Alternative assets have not been fully invested in, and the uninvested allocation is held in domestic equity.

The SBI's domestic equity portfolio returned 6.4 percent, exceeding the Russell 3000 return of 6.1 percent. At the end of 2005, the SBI had over 30 managers in its domestic equity program. The portfolio consists of allocations of one-third passively managed, one-third semi-passive, and one-third actively managed. In aggregate, the active managers performed well in 2005, providing the excess return over the Russell 3000. Small-capitalization value and large-capitalization growth managers provided the best returns, both absolute and relative to their benchmarks. The semi-passive and passive portions of the portfolio performed as expected.

The SBI's fixed income portfolio returned 2.8 percent in 2005, exceeding the benchmark Lehman Brothers Aggregate return of 2.4 percent. All eight of the SBI's fixed income managers exceeded the benchmark, with Morgan Stanley having the highest return, 4.1 percent.

International equity returned 16.4 percent in 2005, just below the benchmark MSCI ACWI ex. U.S. index return of 16.6 percent. During 2005, two active international equity managers were terminated and four were added. Additionally, three new managers undertook a semi-passive developed market strategy that accounts for 10 percent of the international equity portfolio. State Street holds 30 percent of the portfolio in a passively managed account.

Alternative investments returned an astounding 44.8 percent for the SBI in 2005. The SBI does not have a benchmark for alternative investments, but compared to domestic equity and on an absolute basis, returns were outstanding. The SBI's alternative investments include real estate, private equity, resources and yield-oriented investments. Excellent returns are the result of finding and choosing good investments. The SBI has an advantage over Minnesota's other public pension plans – the amount of money they have gives them access to more investments, and pension plans invested with the SBI benefit from this.

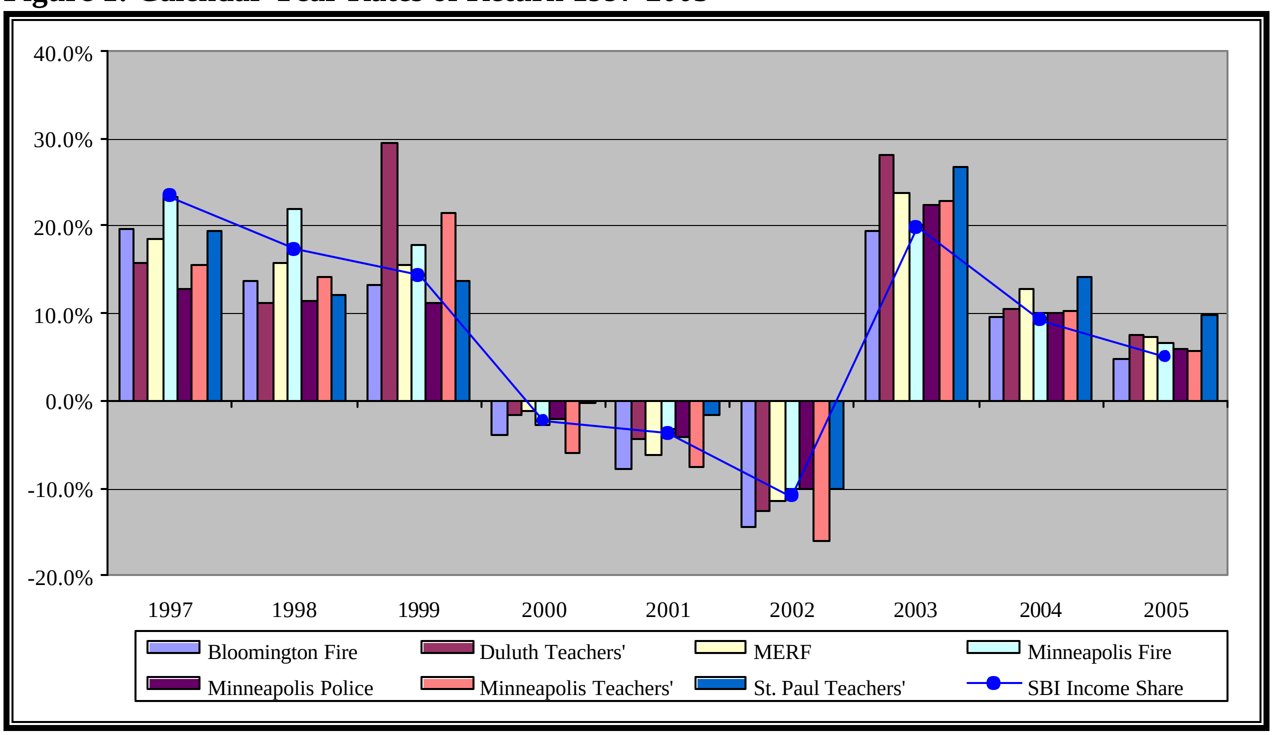
Nine-year Performance Analysis

For the past nine years, from 1997 to 2005, the State Auditor's Office has been collecting and calculating rate of return data for the seven large individual pension plans covered by this report. Over this time period, there is a distinct split between the higher performing plans and the lower performing plans. Minneapolis Police, Minneapolis Teachers' and Bloomington Fire have not kept up with either the other plans or market returns. If you look at the past five years, Minneapolis Police has improved but Bloomington Fire and Minneapolis Teachers' remain at the back of the pack. Since the returns available in capital markets were much lower over the past five years than the past nine years this indicates that these two plans have not been more conservatively invested than other plans; they just do poorly in all market conditions.

Over the past nine years the overall stock market (Russell 3000) returned 7.9 percent, the bond market (Lehman Aggregate Bond Index) returned 6.5 percent, and developed foreign stocks (MSCI EAFE) returned 5.8 percent. A good gauge of returns for a fairly diversified and fairly simple portfolio over this time period is the SBI Supplemental Fund's Income Share Account. This is a real world investment, including fees and expenses, not just an index return. The return was 7.4 percent. This fund's targeted allocation is 60 percent domestic equity (indexed to the overall market), 35 percent in bonds, and 5 percent in cash.

The fact that six of the large plans returned near or greater than the overall stock market return of 7.9 percent indicates that they added value through their investment decisions. Either their investment managers added value, or they benefited by choosing sectors of the stock market that outperformed. Over this time period, all the plans have had at least fairly similar asset allocations, normally holding at least 60 percent of their assets in equities. This indicates that all the plans are looking for long-term growth of assets.

Figure 1: Calendar Year Rates of Return 1997-2005



Poorest Performing Funds

Bloomington Fire

The poorest performing plan, Bloomington Fire returned 5.4 percent over the past nine years. It appears the plan was not able to significantly cash in on the high market returns available in the late 1990s. If this were caused by a conservative asset allocation it would be understandable, but during the bear market from 2000-2002 Bloomington Fire had some of the worst returns of the large plans. The combination of these two factors has placed Bloomington Fire at the bottom of the pile. The plan's investments in the SBI's Income Share and Common Stock Accounts have brought its returns more in line with market returns.

Minneapolis Teachers'

Minneapolis Teachers' nine-year return was 5.9 percent. It had a similar problem to Bloomington Fire in that it was unable to realize significant gains during good market years, although the plan did a little better than Bloomington Fire during the good times and had the worst returns of the large plans during the bear market. Active management and investment selections have not paid off for Minneapolis Teachers', the plan returned only 5.9 percent on its domestic equity portfolio over the past nine years, and 5.1 percent on its fixed income portfolio. At the end of 2005, Minneapolis Teachers' changed its strategy and moved all its domestic equity into passively-managed index funds. Its impending default made this a token effort after years of poor performance. The change was also partly prompted by the traction of legislation to consolidate Minneapolis Teachers' with TRA and the increasingly frequent need to liquidate equities in order to meet current obligations to plan beneficiaries.

Although Minneapolis Teachers' allocation to venture capital has been small over the past nine years, it still hurt returns with a negative 7.1 percent return. Unless some big payoffs come from the plan's current investments in venture capital it has been a definite failure. The first RWI investment, RWI Group III, began in 1998 and their last contribution was $210,000 in 2003, for a total investment of $7,000,000. Minneapolis Teachers' has received distributions of $5,129,325 from this investment as of March 2006. The second investment with RWI, RWI Ventures I, is still being contributed to. As of March 2006 the plan has invested $8,545,000 of a $10,000,000 commitment, and received distributions of $1,644,482.

Minneapolis Teachers' was statutorily consolidated with TRA on June 30th 2006 and TRA has had investment authority over former funds of Minneapolis Teachers' since that date. As of its Fiscal Year 2005 audit conducted by this Office, Minneapolis Teachers' was 44.6 percent funded and had an unfunded actuarial liability of $972.6 million.

Minneapolis Police

Minneapolis Police missed out on the high returns available from 1997 through 1999, with a nine-year return of 6 percent. Since 2000, returns have been decent but still towards the lower end of the large plans. Instead of continually turning over investment managers, Minneapolis Police would have been much better off had they invested in index funds or through the SBI.

Best Performing Plans

The top performing plans over the past nine years were St. Paul Teachers' with a return of 8.8 percent, Minneapolis Fire at 8.7 percent, and Duluth Teachers' at 8.5 percent.

St. Paul Teachers'

St. Paul Teachers' has been the best performing plan. Its recent returns have been impressive, easily exceeding market returns. St. Paul Teachers' had the highest return of the large plans in 2004, while it was second in 2005. Domestic equities have fueled the plan's performance, with active management and sector selection both contributing to its gains. St. Paul Teachers' is invested in the same RWI Ventures I fund that Minneapolis Teachers' is invested in. As this investment matures its success will be determined.

Minneapolis Fire

Minneapolis Fire did very well during the late 1990s, exceeding all the other plans' returns from 1997 to 1999. Minneapolis Fire also was the best performing plan in 2002, the worst year for equities in the nine-year period. Money manager Alliance Capital was responsible for much of Minneapolis Fire's success. During 2005, Minneapolis Fire opened two international equity accounts and a global natural resources account after not using international equity during the previous eight years. The lack of international equity most likely helped them over the nine-year period.

Duluth Teachers'

Duluth Teachers' began the nine-year period on a seesaw, having the worst returns among the large plans in 1998 and the best in 1999. Since then, the plan has been one of the top performers. Sector selection and active management in domestic equities and excellent returns by fixed income manager Western Asset Management have helped Duluth Teachers' exceed overall market returns.

Other Plans

State Board of Investment

The SBI Basic Fund returned 8.3 percent over the nine-year period, while the Post Fund returned 7.9 percent. Fixed income, international equity, and alternative assets have performed well for the SBI. The Basic Fund has traditionally had a higher allocation to alternative investments, possibly accounting for the higher return, although recently the Post Fund has had increased assets in alternatives. The SBI's success record with alternative investments has generally been dramatically better than that of the other plans.

MERF

The Minneapolis Employees Retirement Fund's (MERF) return over the past nine years was 7.8 percent. MERF has generally met or exceeded market returns, and a real estate investment trust portfolio that has returned 14.1 percent since inception in 1997 has helped significantly. The 7.8 percent return does not include MERF's deposit accumulation fund, which has held the active members' assets since mid-2003. This is a very small account, and is used to protect the assets from market fluctuations.

Overview of Contributions, Benefits, Funding Ratios, Administrative Expenses, and Investment Costs

Contributions

Pension plans may receive contributions from employee-members, the public employer, and from the State. Generally contribution formulas work in such a way that employee contributions are fixed by statute, as are state contributions with any deficiencies in funding falling on the public employer.

Figure 2: Fiscal Year 2005 Contributions

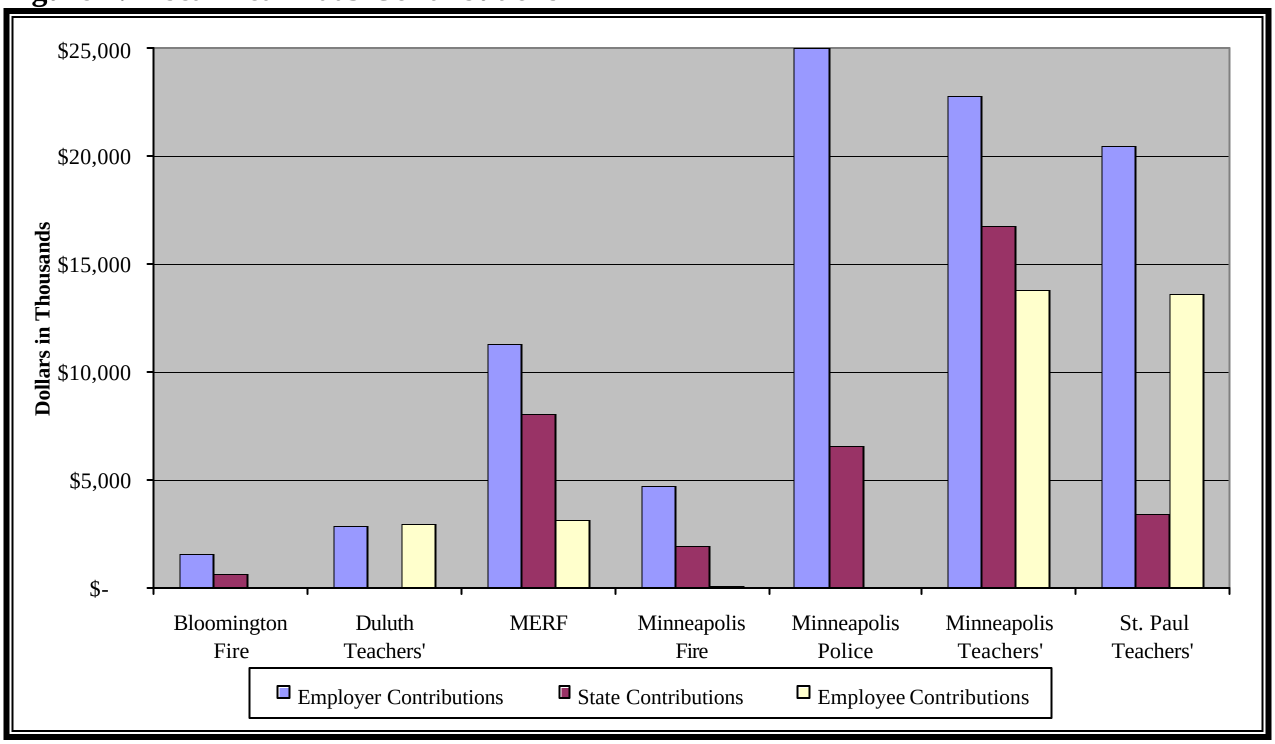


Figure 2 breaks out 2005 contributions received by the seven pension funds from employees, employers, and the State. MERF and Minneapolis Teachers' received the highest contributions during 2005 from the State. Minneapolis Police and Minneapolis Teachers' received the highest employer contributions. Employees contribute less than the State or public employers.

Appendix Table 2-C shows the rate of employee contributions. The total combined amount received for employee contributions in these seven pension plans peaked in 2002 at $40.4 million. Each year since then, the combined total employee contributions have dropped. In 2005, the total employee contributions to these plans were $33.4 million. The three closed pension plans; MERF, Minneapolis Police, and Minneapolis Fire; have fewer active members to contribute to the plans. Minneapolis Police had no employee contributions and Minneapolis Fire received only $12,010 from employees. This reflects that almost all of the members of these two plans are no longer active employees.

State contributions peaked in 1998 at $44.1 million, and have varied in each of the last nine years. In 2005, the State contributed $37.3 million to these pension plans. See Appendix Table 2-A. Minneapolis Teachers' and MERF were the largest recipients in 2005, receiving $16.8 million and $8.1 million, respectively. Duluth Teachers' received no State contribution in 2005 or the prior two years. In the last nine years, Duluth Teachers' received the least amount of funding from the State, $2.4 million. Minneapolis Teachers' received $143.8 million in nine years from the State, over and above the costs associated with consolidating with TRA in 2006.

Total employer contributions for the seven pension plans declined from $109.6 million in 2004 to $88.7 million in 2005. Much of this $21 million drop was due to the difference in contribution levels to MERF. See Appendix Table 2-B. MERF received $11.3 million from the City of Minneapolis in 2005, after having received over $38 million in each of the two prior years. Minneapolis Police received almost $25 million from the City in 2005, and a total of $59.3 million in the past three years. Employer contributions for the three teacher plans were relatively stable the past three years. Bloomington Fire received total City contributions for the past three years of $5.3 million. The City of Bloomington did not contribute to this fund for the five previous years.

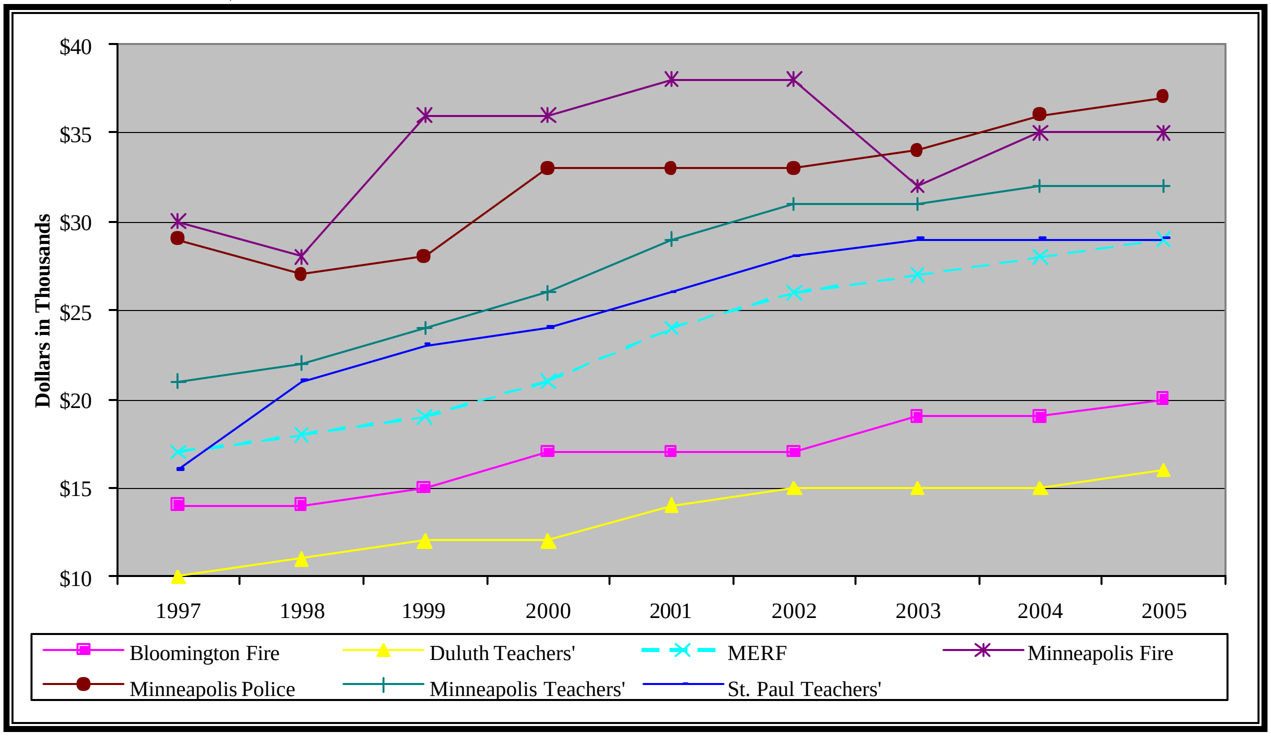
If you consider the total contribution per member, Minneapolis Police was the highest at $34,257. See Appendix Table 2-D. Minneapolis Police has been the highest per member for the past four years, even though employee contributions have been minimal. Minneapolis Teachers' was $3,931 per member in 2005; St. Paul Teachers' was $3,776; and Duluth Teachers' was $1,766.

Benefits

Benefit payments made by a pension plan directly affect its health. The rate at which benefits increase greatly impact a plan's funding level.

For each of the plans, except Minneapolis Fire and Minneapolis Police, the average total benefit payments per member increased each year from 1997 to 2005. See Appendix Table 3. Minneapolis Police had the highest average of total benefits payments per retired member/beneficiary in 2005 in the amount of $37,378; followed by Minneapolis Fire at $35,141; Minneapolis Teachers' at $32,352; St. Paul Teachers' at $29,349; MERF at $28,681; Bloomington Fire at $19,744; and Duluth Teachers' at $15,931. The pension plan rankings of the average benefit amount have been the same for the past three years. For the six years from 1997 to 2002, Minneapolis Fire had the highest average amount and Minneapolis Police was second.

Figure 3: Average of Total Benefits Payments by Retired Member/Beneficiary (Fiscal Years 1997-2005)



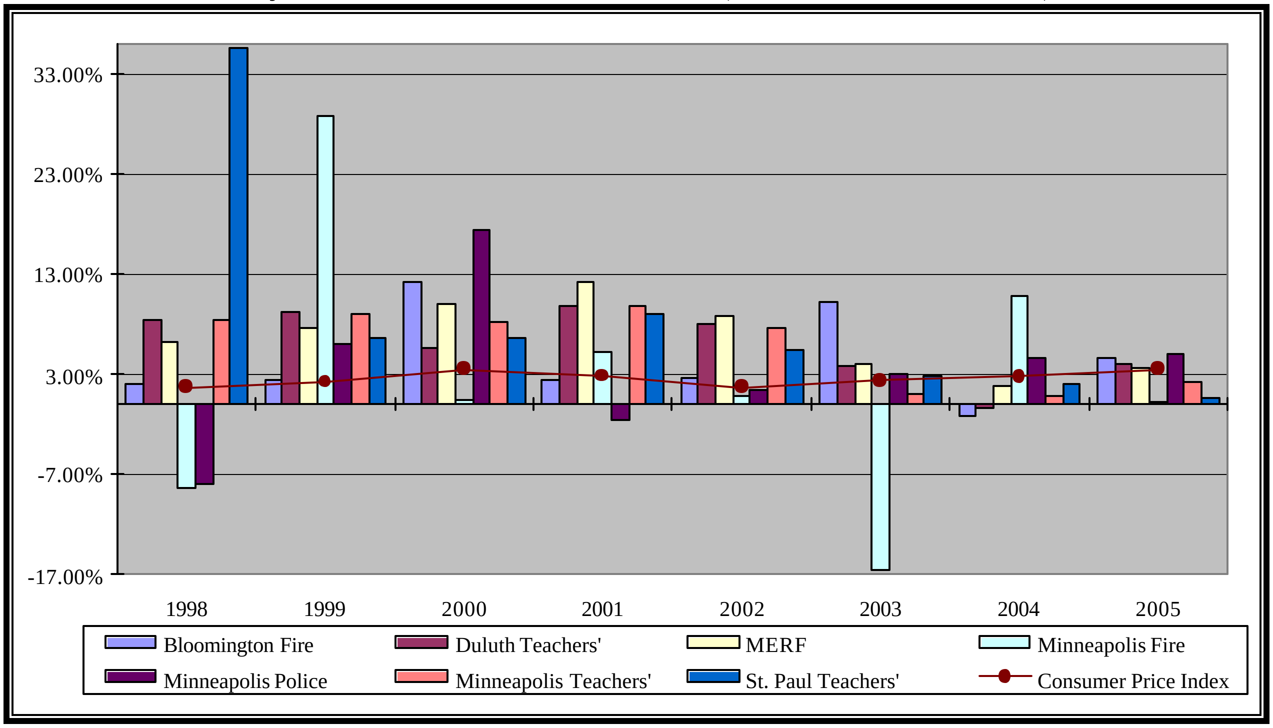
All of the pension plans covered in this report, except Bloomington Fire, increase the overall payout of benefits when investment returns exceed actuarial assumed rate of return over a certain time period. For Minneapolis Fire and Minneapolis Police, the increased benefit comes in the form of a 13th check, bonus payment. MERF and the teachers' plans permanently increase their benefit payments moving forward, which results in an increased actuarial liability since the new benefit level is the baseline thereafter. Critics of this investment-driven benefit increase mechanism have questioned the rationale of permanently increasing benefits based on investment returns, pointing out that such a scheme provides no permanent funding source to support the new benefit level and the increased benefit level is not subject to repeal or modification in the event of investment downturn.

Some of the effects of these investment-driven benefit increases can be seen in the above table, which sets forth percentages of benefit increases (and decreases) by retiree or beneficiary member between 1998 and 2005 as compared to the Consumer Price Index (CPI). Although there are other factors at work in these numbers; such as retirements, deaths, and change in pension unit value; much of the increases and decreases are driven by investment performance based bonus checks and pension increases.

From 1998 to 2002, the benefit increases of MERF, Minneapolis Teachers', St. Paul Teachers', and Duluth Teachers' outpaced the CPI every year. Some funds even outpaced the CPI during the past three years, after heavy investment losses in 2001 and 2002 greatly lowered their net assets. See Appendix Table 4.

The yearly benefit amount changes for Minneapolis Fire and Minneapolis Police vary widely during this time period with both funds having a decrease of over 8 percent in 1998 and large increases in certain subsequent years: 28.7 percent for Minneapolis Fire in 1999 and 17.5 percent for Minneapolis Police in 2000. This is due in large part to investment-driven 13th check bonuses. Like the teacher funds, the rates of increase have slowed since 2002 for these two funds.

Figure 4: Percent Increase in Average of Total Benefit Payments by Retired Member/Beneficiary and the Consumer Price Index (Fiscal Years 1997-2005)



For all of the plans, the dollar amount of per member benefits has increased dramatically from 1997 to 2005. As a percentage increase for 1997 through 2005, beneficiaries have experienced the following increases:

Average Benefit Payments Change from 1997 to 2005

	Average Benefit per Beneficiary 2005	Dollar Increase from 1997 to 2005	Percentage Increase from 1997 to 2005
Bloomington Fire (12/31)	$19,744	$5,637	40.0%
Duluth Teachers' (6/30)	$15,931	$5,919	59.1%
Minneapolis Employees (6/30)	$28,681	$11,643	68.3%
Minneapolis Fire (12/31)	$35,141	$4,899	16.2%
Minneapolis Police (12/31)	$37,378	$8,320	28.6%
Minneapolis Teachers' (6/30)	$32,352	$11,782	57.3%
St. Paul Teachers' (6/30) *	$29,349	$13,568	86.0%

* The St. Paul Teachers' amount for 1997 is artificially low because the Pension Uniformity legislation passed in 1997 made several substantive changes in the benefits for participants in this plan. These changes included the fundamental structural change in post-retirement benefit adjustments from the old "13th check" approach to the new "2 percent plus excess earnings"

approach. The final 13th check was recognized as a payable in 1996. Benefits increased significantly during 1998 because of incentives from the School District to retire before January 1, 1998 (reduced post-retirement health benefits after that date) and a 7 percent increase on pension bases on January 1, 1998, due to the Pension Uniformity legislation passed in 1997 regarding the 13th check approach.

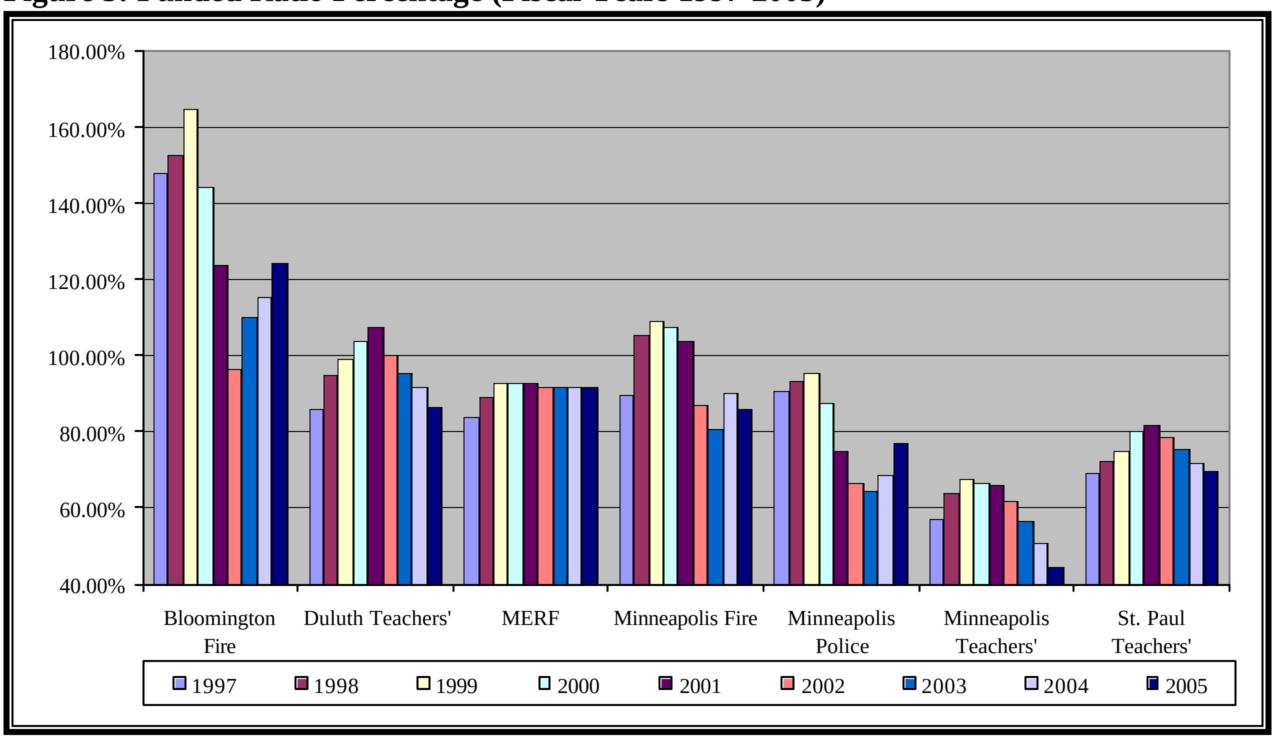
The rate of increase itself may not indicate an inappropriate progression in benefit levels, especially if the plan's initial benefit level was low. As indicated, Minneapolis Police and Minneapolis Fire had the lowest rates of increase for this nine-year period, but throughout they had, and continue to have, the retirees with the highest annual benefit levels.

The 2006 Legislature capped investment benefit increases for St. Paul Teachers' and the statewide plans: TRA, MSRS, and PERA. This limitation does not take effect until 2010.

Funding Ratios and Unfunded Liabilities

Actuarial funding measures how well a plan is funded by showing the relationship between the plan's assets and liabilities. These funding ratios are important indicators as to whether additional contributions to the plan will be needed and whether a benefit increase can be afforded. Simply looking at whether a pension plan's net assets continue to increase does not tell whether a pension plan is in good shape.

Figure 5: Funded Ratio Percentage (Fiscal Years 1997-2005)



Funding ratios from 1997 to 2005 are set forth in Figure 5. Despite the increase in contributions over this time period the funding levels have not been increasing. This means that the unfunded liabilities have been increasing. The total combined unfunded liability for these seven pension plans was nearly $1.7 billion in 2005, of which Minneapolis Teachers' was 58.2 percent. The amount of combined unfunded liability has increased every year since 1999.

One exception to the underfunding trend is Bloomington Fire, which went from a 115.1 percent funding ratio in 2004 to 124.2 percent in 2005. Minneapolis Police also improved its funding level going from 68.6 percent funding in 2004 to 77.3 percent funding in 2005. As previously discussed, during 2005, Minneapolis Police received over $31.5 million in contributions from the City of Minneapolis and the State. Additionally, Minneapolis Police should have had improved funding levels in 2005 as a result of legislation passed in 2004 that extended its full funding date. Minneapolis Teachers' continued its downward funding trend going from 50.8 percent funded in 2004 to 44.6 percent funded in 2005. Again, Minneapolis Teachers' was consolidated into TRA on June 30, 2006.

Minneapolis Fire's funding level dropped from 90.2 percent in 2004 to 86.2 percent in 2005. Of the remaining funds, St. Paul Teachers' had the lowest level of funding at 69.7 percent. Since 2001, when its funding level was 81.9 percent, the unfunded liability of St. Paul Teachers' has increased each year. MERF has remained at 92 percent since 2002.

Figure 6: Total Actuarial Accrued Unfunded Liability (Fiscal Years 2001-2005)

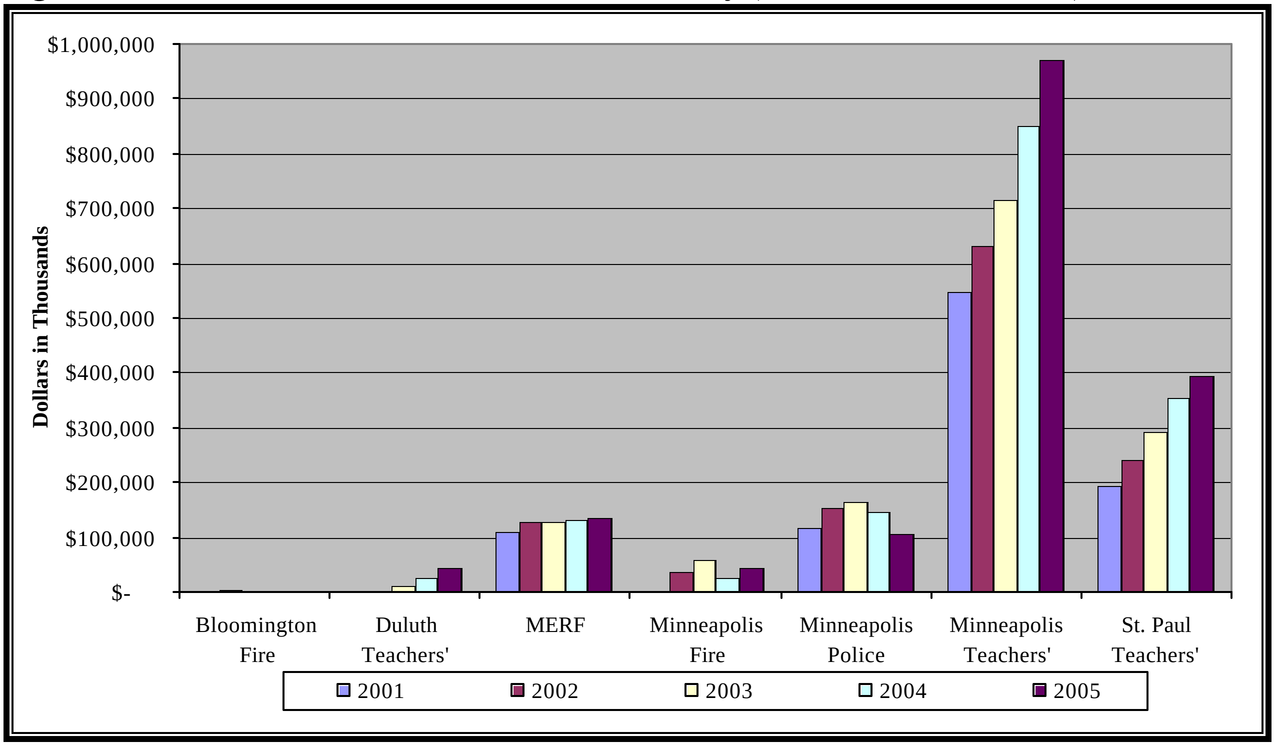
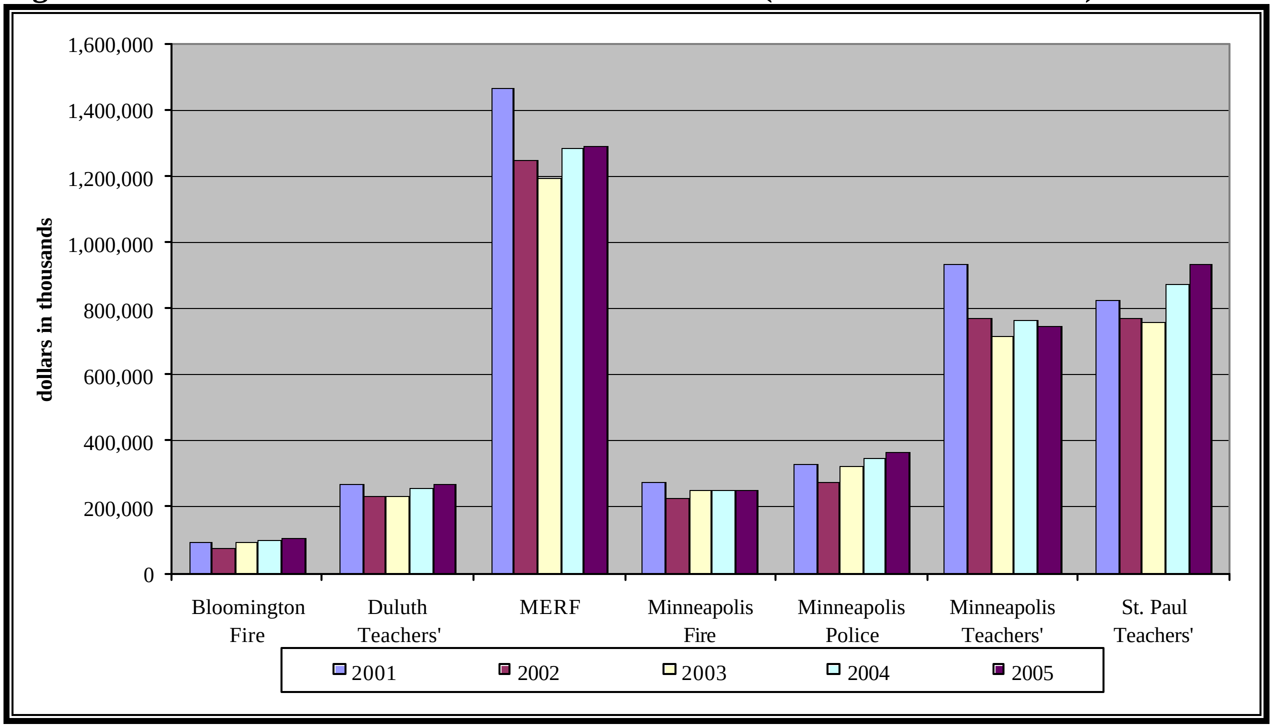


Figure 6 shows the increase (or decrease) in unfunded liability over the past five years. The crisis situation of Minneapolis Teachers' is evident as its 2005 unfunded liability reached nearly the $1 billion level. The next highest accrued unfunded liability was St. Paul Teachers', with an expanding unfunded liability each year to a high of $394.5 million in 2005.

The amount of unfunded liability is sometimes overlooked because the net assets of the pension plans continue to rise. For example, St. Paul Teachers' unfunded liability increased by $41.9 million in 2005, even though the plan's assets rose by $62.8 million in the same year. Duluth Teachers' net assets rose by $8.6 million in 2005, while its unfunded liability rose by $17.7 million; MERF's net assets rose by $5.4 million, and its unfunded liability rose by $4.9 million. Only the net assets for Minneapolis Teachers' dropped in 2005 by $17.9 million. The rise in unfunded liabilities while net assets are increasing can, at least in part, be attributed to the increase in benefits paid.

Figure 7: Net Assets Held in Trust for Pension Benefits (Fiscal Years 1997-2005)

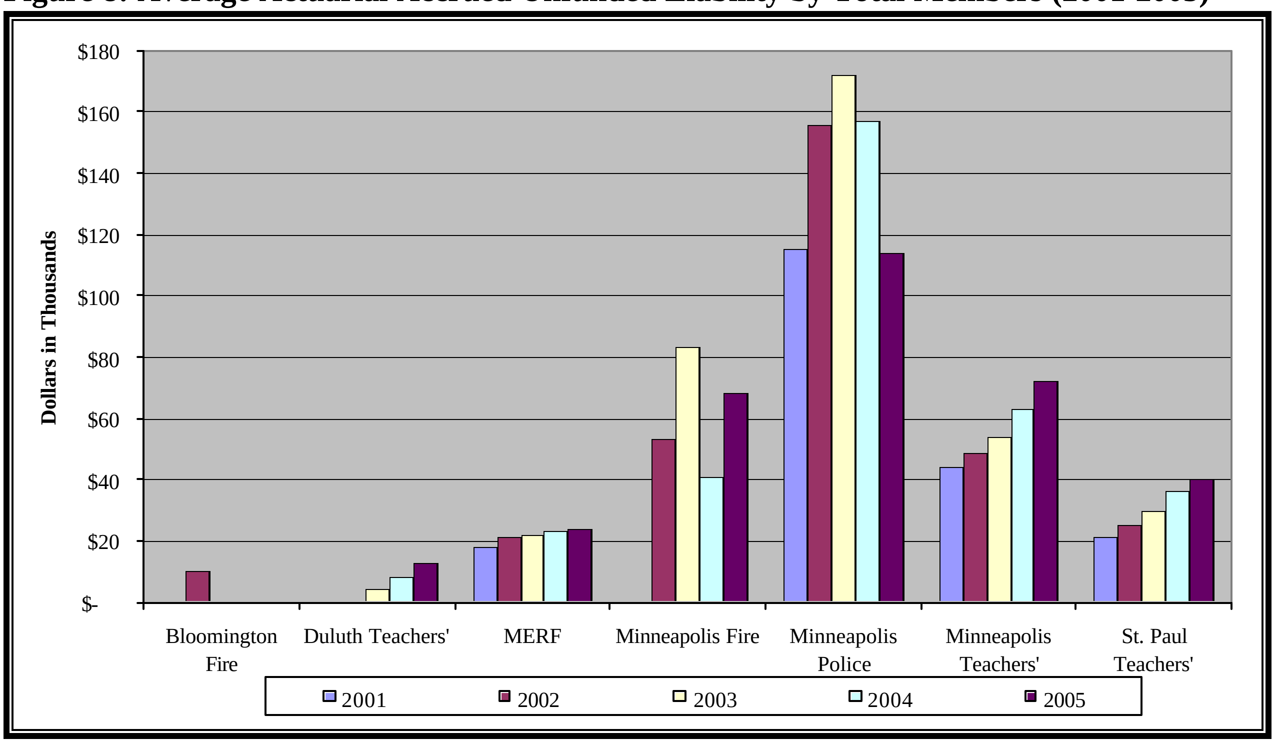


As discussed in the Benefits section, for most of these pension plans, benefit levels are impacted by investment returns. For the Minneapolis Fire and Minneapolis Police plans, good investment returns result in an extra, 13^{th} check, giving a one-time spike to members' benefit levels for that year. For MERF and the teacher plans, good investment returns result in a permanent benefit increase, which thereafter affects their funding level.

For instance, St. Paul Teachers' has an investment driven benefit increase where permanent benefit increases can be triggered by investment returns. Total benefit increases between 2001 and 2005 for Saint Paul Teachers' were over 35 percent. The unfunded liability of St. Paul Teachers' has grown to $394.5 million in 2005 or $39,816 per member. See Appendix Tables 6 and 8. To make up this escalating funding shortfall, St. Paul Teachers' is in a Catch-22 situation. The plan has four sources of income: employer contributions, employee contributions (declining since 2002, see Appendix Table 2-C), state contributions, and investment returns. During the same time period that the unfunded liability increased, employer contributions and state contributions remained fairly constant. Therefore, the only source of income available to the plan to overcome the funding deficit is investment income. However, good investment returns trigger additional benefit increases and additional unfunded liabilities. With investment returns effectively hobbled as a possible method of solving the growing unfunded level, the only options left open to the St. Paul Teachers' plan are increasing contributions (from employer and employees) or decreasing (or holding down the rate of increase of) benefit payments. Both of the options will be difficult for the elected fiduciaries of the St. Paul Teachers' Board of Trustees. Prior to its elimination, a similar dilemma faced the Minneapolis Teachers' plan, obviously without any successful resolution by its Board of Trustees.

Figure 8 shows the unfunded liability per member for the past five years. Bloomington Fire is fully funded. Minneapolis Police has the highest unfunded amount per member at $114,213 in 2005, followed by Minneapolis Fire at $67,613 per member. It would be expected that closed plans, such as these two, would have smaller unfunded liabilities per member since they have very little employee contributions to their plans; however, the teachers' plans all had lower average unfunded liability per member in 2005 (Duluth Teachers', $12,987; St. Paul Teachers', $39,816; and Minneapolis Teachers', $71,638). The closed plans have higher ratios of net assets to total members (Minneapolis Police, $397,836 per member; Minneapolis Fire, $398,784 per member; and MERF, $232,342 per member). See Appendix Table 8. The teachers' plans, which have large bases of active employees who are still contributing, have lower ratios of total net assets to total members (Duluth Teachers', $81,819 per member; St. Paul Teachers', $94,325 per member; and Minneapolis Teachers', $54,892 per member).

Figure 8: Average Actuarial Accrued Unfunded Liability by Total Members (2001-2005)

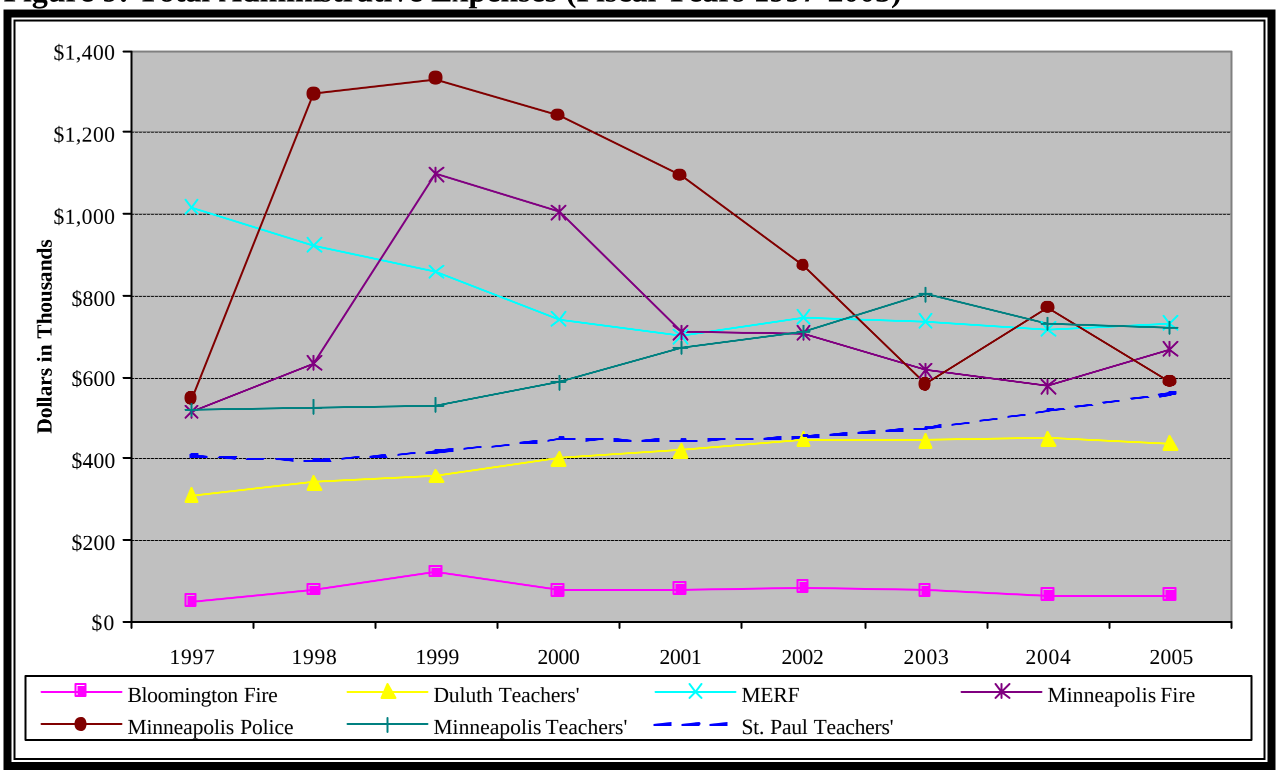


Administrative Expenses

State law permits pension plans to pay certain administrative expenses. These expenses are paid from the pension assets and directly affect the funding levels of the various plans. The impact of these administrative expenses varies greatly depending on the size of the plan. Smaller plans have fewer members and usually fewer total assets from which to pay these expenses.

We have broken out the administrative expenses, excluding investment expenses, into four areas: Personnel Services, Legal Fees, Professional Services, and Other Expenses. Personnel Services represent the payroll and other related expenses for the staff of the pension plan. Legal Fees represent amounts paid to law firms. Professional Services represent fees paid to professionals other than attorneys and includes actuary, auditing, and accounting expenses, but not investment costs. The "Other" expenses include everything else from postage stamps to travel expenses. See Appendix Tables 9 and 13.

Figure 9: Total Administrative Expenses (Fiscal Years 1997-2005)

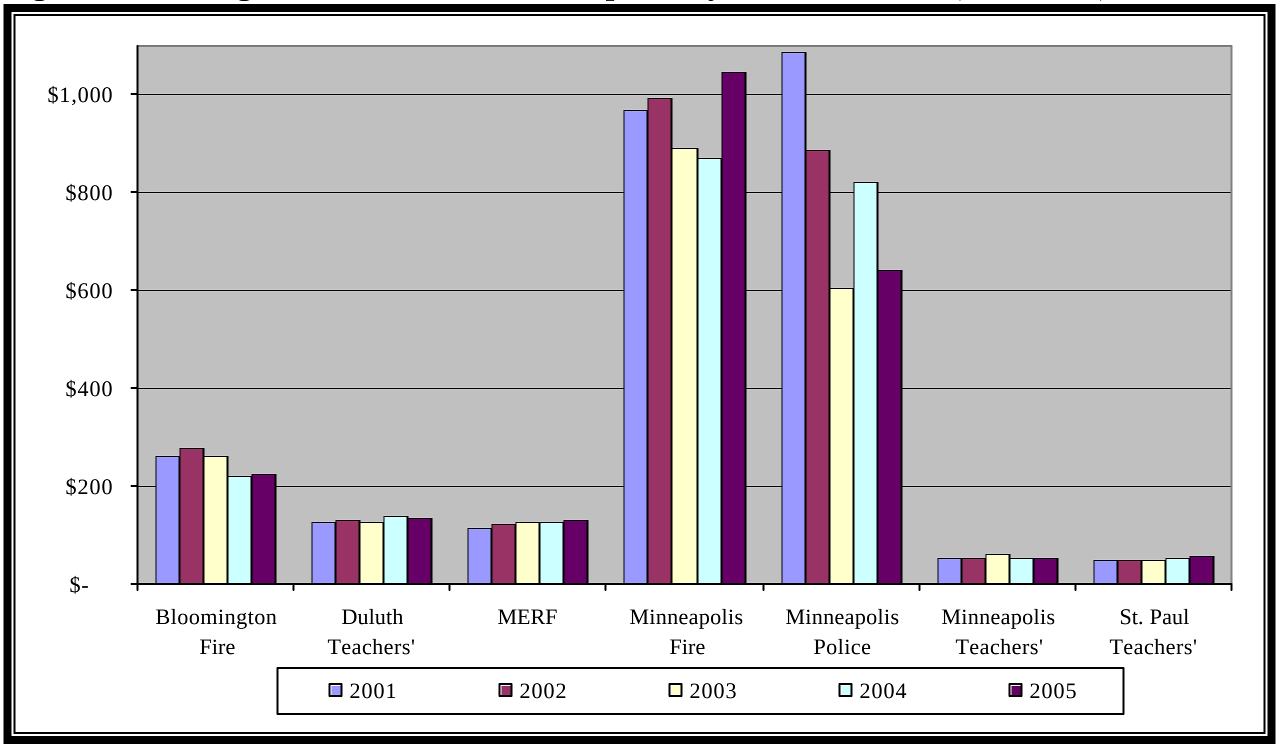


MERF had the highest total administrative costs in 2005 at $731,566 and Bloomington Fire and Duluth Teachers' had the lowest at $64,844 and $436,507, respectively.

On a cost per member basis, MERF's administrative expenses translate to $132 per member. St. Paul Teachers' and Minneapolis Teachers' had the lowest administrative costs per member at $56 and $53, respectively. As in 2004, the highest administrative costs per member in 2005 are Minneapolis Police at $640 per member and Minneapolis Fire at $1,047 per member.

In 2004, Minneapolis Fire spent $871 per member, so the 2005 amount represents a 20 percent increase. Minneapolis Police however decreased from $820 per member to $640 per member, a decrease of 22 percent. As the following figure shows, the cost per member is hundreds of dollars higher for Minneapolis Police and Minneapolis Fire than for any of the other plans. This is not a limited occurrence, but a trend that has existed since at least 1997. As closed plans, Minneapolis Fire and Minneapolis Police receive minimal employee contributions and nearly this entire expense is borne by the City of Minneapolis and its taxpayers.

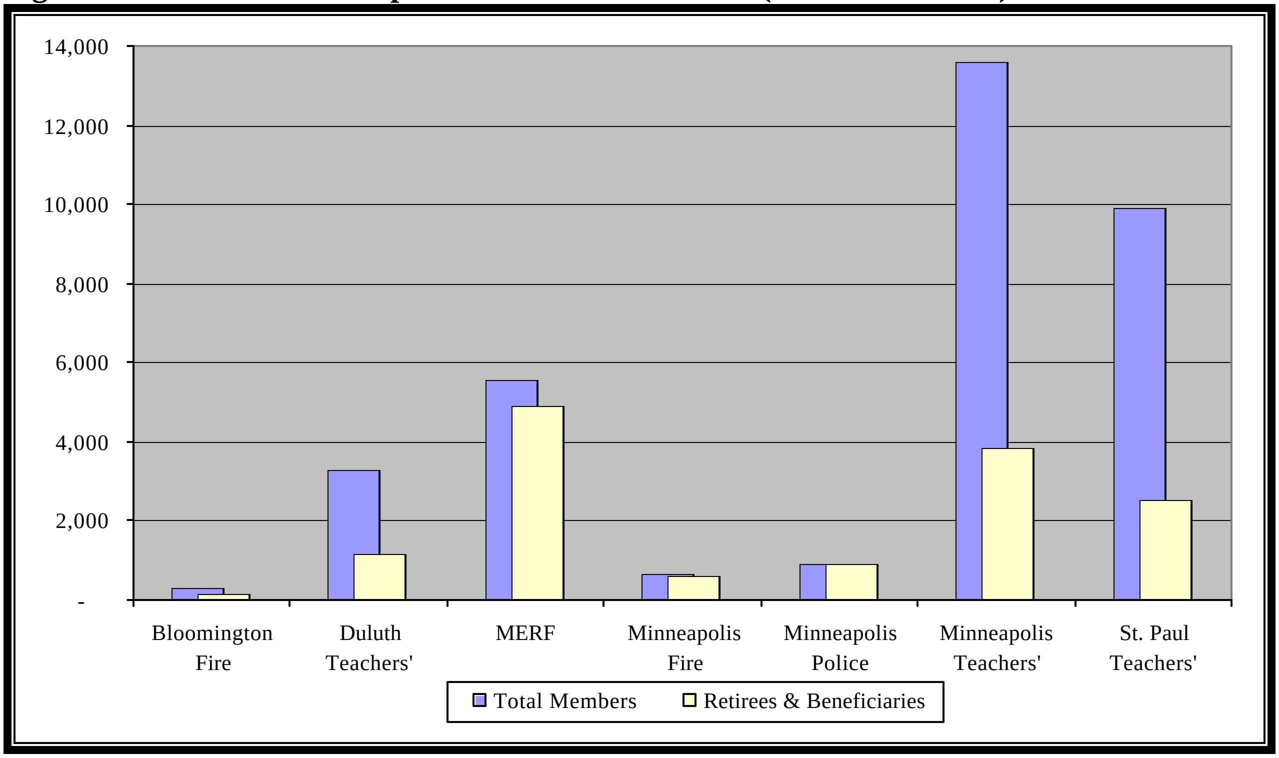
Figure 10: Average Total Administrative Expense by Total Members (2001-2005)



It is in the area of Legal Fees that Minneapolis Fire and Minneapolis Police are by far the highest spenders. See Appendix Table 13. Minneapolis Fire expensed $188,179 in 2005 as legal fees and Minneapolis Police spent $116,532 on legal fees. To put this in perspective, Duluth Teachers' had $2,274 in 2005. Both Minneapolis Fire and Minneapolis Police had at least 20 percent of their administrative expenses allocated to legal fees. No other fund had over 5 percent of their administrative expenses in legal fees.

If all of the legal fees spent by all of the other plans in 2005 were added together, they would only equal 15.9 percent of the amount spent on legal fees by Minneapolis Fire and Minneapolis Police. These two plans spent $304,711 out of the total $353,076 legal fees for the seven plans in 2005. Minneapolis Fire and Minneapolis Police have only 1,559 members or 4.6 percent of the membership of these seven plans. This 4.6 percent of the pooled pension plan membership is incurring over 86 percent of the attorney fees paid by all plan members.

Figure 11: Total Membership versus Retired Members (Fiscal Year 2005)



Investment Costs

Investment costs are any amounts paid by the plans to outside investment and portfolio managers, as well as commissions, management and transaction fees, and other charges imposed by the funds and brokerage houses with which the pension plans have invested their money. Some of the plans also allocate expenses of their internal staff who work on investments. Investment costs can be thought of as the price paid to grow the assets of the plan through investment. The investment Rate of Return calculated by the pension plans and by the State Auditor's Office is net of investment costs.

Over the past nine years, the total investment costs paid by the seven large public pension plans has ranged from $11,090,590 to $15,647,163. See Appendix Table 12. For 2005, the total amount paid was $12,566,564; down slightly from the previous year. In 2000, when investment expenses totaled $15.6 million, the plans had combined assets of $4.7 billion. In 2005, the total assets were only $4.0 billion.

It is very common for brokerage houses and investment managers to impose a management charge of a percentage of the assets invested. In such an arrangement, the pension plans with the most money invested will pay higher investment costs than a pension plan with a smaller asset total. However, other factors affect the total level of investment costs. For example, a strategy of active management is more costly than passive management because of the increased research, analysis, and portfolio adjustments typically involved. All of the plans should take careful assessment of their past practices and investment rates of return to evaluate whether the increased cost of active management is justified in their particular circumstances. This is especially true in light of often-repeated assertions that fully 70% of money managers fail to beat the market and exceed the return that would have been realized by a passively-managed portfolio.

The State Board of Investment can charge extraordinarily low investment costs because of its in-house expertise and its huge total of assets under management. The SBI Income Share account, for instance has investment management fees of just 0.01%. Several of the large public pension plans have taken advantage of the low investment costs of SBI as an alternative to more expensive, actively-managed accounts.

Recommendations and Conclusions

Minnesota's seven large individual public pension plans are a mix of diverse and independent-minded entities. While they exist for the same purpose and strive for the same goals, the separate plans can and do exhibit significantly divergent priorities, management philosophies, and conceptual notions of fiduciary duty. In some cases, these differences had significant impact on the performance and overall solvency of the plans, both in 2005 and over the nine-year comparison period. The State Auditor makes these observations and recommendations:

- The trend continues to be an increase in levels of unfunded liability. Six of the seven plans are less than 100 percent funded and five of the seven saw their funded ratio either hold even or worsen in 2005.

- Since, in the aggregate, Minnesota's large public pension plans have a deficient and declining funding level, the Legislature should give serious consideration to prompt and dramatic revision of investment-based pension benefit increases.

- Pension benefit payouts have increased substantially over the last nine years at a pace and percentage size that belie the declining fiscal health of many of the plans. Legislative intervention is necessary to alter the plans' governance rules to bring benefit increases in check and make them reflective of an individual plan's current and projected financial condition.

- Contributions to the public pension plans by state and local taxpayers have increased significantly over the past nine years, and yet funding shortfalls remain a serious problem. The most significant explanation for this apparent dichotomy is that the increased taxpayer contributions to the pension plans are being paid out to the beneficiaries in the form of rising benefit levels instead of being used to address any unfunded liabilities and shore up the overall solvency of the plans.

- Over the past few years, the pension plans have had dramatically differing degrees of success with various investment managers and investment philosophies. The State Board of Investment has delivered consistently good performance and is a unique and outstanding resource available to the public pension plans of Minnesota. Every authorized pension plan in the state should consider availing itself of SBI's expertise and proven track record. Bloomington Fire and Minneapolis Police should give particular thought to investing more through SBI, as they have not added any value, over indexing, by investing on their own.

- Particularly in light of the precarious funding position of many of the plans, fiduciaries of the large public pension plans must be doubly-conscious of their management practices and administrative expenses. Recent and enhanced public awareness of pension issues has made this "heightened frugality" all the more important. Though there has been some improvement, the administrative expenses of Minneapolis Fire and Minneapolis Police remain unacceptably and anomalously high.

- Due to the nature of pension plan management structures, the fiduciaries of the plans are very often in a poor position to adequately meet the fiduciary duty they owe to state and local taxpayers who contribute to the plan. This problem is especially acute in circumstances where the interests of taxpayers and the interests of pension plan beneficiaries might come into conflict. In such instances, the system is weighted in a way that puts tremendous pressure on fiduciaries to favor plan members over taxpayers.

- Apart from the SBI's highly successful program, venture capital or private equity type investments have generally not been successful and should be avoided in most cases in favor of more proven options.

Aside from specific recommendations, recent and dramatic events have warranted a general assessment of Minnesota's public pension plans. The Legislature's 2006 abolishment of the Minneapolis Teachers' Retirement Fund Association has already proven to be a watershed event in the long history of taxpayer-funded pensions in this state. The demise of Minneapolis Teachers', and revelation of the huge and long-term taxpayer investment necessary to safeguard the plan's beneficiaries, led to unprecedented public and media discussion of the solvency of large public pension plans. The negative perception was exacerbated by a pattern of questionable actions undertaken by the fiduciaries of Minneapolis Teachers' in the waning weeks and months of the plan's existence.[6] The events of 2006 might prompt considerable changes in attitude and policy with respect to public pensions in Minnesota.

Pension plans now exist in a changed atmosphere, not only in Minnesota but also throughout the country, and not only in the public sector, but in the private as well. The plight of Minneapolis Teachers' forced a comprehensive and broad-based discussion of general concepts, such as funding ratios, and specific ones, such as management responsibilities and the definition and boundaries of fiduciary duty.

In the face of a new climate of public awareness, mounting budgetary pressures, and dubious management practices on the part of a failed plan, various concepts related to Minnesota's public pension plans might have to be reevaluated in the near future. The State Auditor believes that there is a continuing and valuable role in the 21st century for large, defined-benefit public pension plans as long as they are stringently managed in a way which safeguards the interests of both the plan beneficiaries and the taxpayers.

[6] *See* Minneapolis Teachers' Retirement Fund Association Special Review Report; Office of the State Auditor – October 3, 2006

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2005 Plan Summaries

Bloomington Fire Department Relief Association

Year Ending December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)

OSA One-Year ROR	4.7 %
Plan One-Year ROR	5.1 %
Benchmark ROR	4.2 %
Actuarial Assumed ROR - Active	6.0 %
Actuarial Assumed ROR - Retired	6.0 %
OSA Three-Year ROR	11.0 %
OSA Five-Year ROR	1.5 %

Benchmark Components and Rates of Return	
S&P 500	4.9 %
Lehman Bros. Aggregate	2.4 %

Policy Asset Allocation	
Domestic Equities	70.0 %
Fixed Income	30.0 %

Actual Asset Allocation	
Domestic Equities	64.9 %
Fixed Income	27.3 %
Cash	7.8 %

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 1,820	$ 10,000	$ 969	$ 12,789	6.1 %
Cash	Cash	9	(4)	0	5	0.0 %
Internally Managed	Balanced	15,473	(867)	402	15,008	2.9 %
SBI Income Share	Balanced	77,133	(10,000)	3,176	70,309	5.0 %
WCM Investment Management	Balanced	7,153	(4)	138	7,287	2.0 %
	Total	**$ 101,588**	**$ (875)**	**$ 4,685**	**$ 105,398**	

Duluth Teachers' Retirement Fund Association

Year Ended December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)	
OSA One-Year ROR	7.6 %
Plan One-Year ROR	7.6 %
Benchmark ROR	5.6 %
Actuarial Assumed ROR - Active	8.5 %
Actuarial Assumed ROR - Retired	8.5 %
OSA Three-Year ROR	15.1 %
OSA Five-Year ROR	5.0 %

Benchmark Components and Rates of Return	
S&P 500	4.9 %
Russell 2500 Value	7.7 %
Russell 2000 Growth	4.1 %
Lehman Bros. Aggregate	2.4 %
MSCI EAFE	13.5 %
90-Day U.S. Treasury Bill	3.1 %
NCREIF	20.1 %

Policy Asset Allocation	
Equities: Large Cap	30.0 %
Equities: Small/Mid Cap Value	10.0 %
Equities: Small Cap Growth	13.0 %
Fixed Income	30.0 %
International Equities	12.0 %
Cash	3.0 %
Real Estate	2.0 %

Actual Asset Allocation	
Equities: Large Cap	27.8 %
Equities: Small/Mid Cap Value	10.7 %
Equities: Small Cap Growth	13.5 %
Fixed Income	24.5 %
International Equities	16.8 %
Cash	1.0 %
Real Estate/Real Assets	5.7 %

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 152,322	$ (19,723)	10,960	$ 143,559	8.0 %
Fixed Income	Fixed Income	76,253	(10,773)	2,290	67,770	2.9 %
PIMCO	Real Assets	0	8,000	(178)	7,822	(2.2)%
Wellington	Real Assets	0	5,300	381	5,681	7.2 %
International Equities	International Equities	34,484	6,000	5,814	46,298	16.7 %
Cash	Cash	4,659	(2,108)	95	2,646	2.5 %
Real Estate	Real Estate	2,373	(268)	259	2,364	11.5 %
	Total	**$ 270,091**	**$ (13,572)**	**$ 19,621**	**$ 276,140**	

Minneapolis Employees Retirement Fund

Year Ended December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)

Plan One-Year ROR	7.3 %
Benchmark ROR	7.6 %
Actuarial Assumed ROR - Active	6.0 %
Actuarial Assumed ROR - Retired	5.0 %
Plan Three-Year ROR	14.7 %
Plan Five-Year ROR	4.6 %

Benchmark Components and Rates of Return	
Russell 3000	6.1 %
Custom Fixed Income [1]	2.8 %
MSCI ACWI Ex. U.S.	16.6 %
MSCI ACWI	10.8 %
Wilshire REIT	13.9 %

Policy Asset Allocation	
Domestic Equities	40.0 %
Fixed Income	30.0 %
International Equities	15.0 %
Global Equities	10.0 %
Real Estate	5.0 %
Cash	0.0 %

Actual Asset Allocation	
Domestic Equities	40.2 %
Fixed Income	27.6 %
International Equities	16.7 %
Global Equities	9.4 %
Real Estate	5.1 %
Cash	1.0 %

Asset Class	**Investment Type**	**Beginning Market Value**	**Net Cash Flow (Net of Fees)**	**Investment Return**	**Ending Market Value**	**Rate of Return**
Domestic Equities	Domestic Equities	$ 511,090	$ (30,000)	$ 23,374	$ 504,464	4.6 %
Fixed Income	Fixed Income	339,156	(4,244)	$ 11,269	346,181	3.0 %
International Equities	International Equities	202,873	(24,039)	$ 30,239	209,073	16.5 %
Global Equities	Global Equities	128,033	(27,000)	$ 16,492	117,525	13.3 %
Real Estate	Real Estate	69,143	(14,000)	$ 9,559	64,702	17.1 %
Cash	Cash	15,594	(3,006)	$ 196	12,784	1.0 %
Deposit Accumulation Fund [2]	Low Duration Fixed Income	60,643	(21,644)	$ 587	39,586	1.5 %
	Total	**$ 1,326,532**	**$ (123,933)**	**$ 91,716**	**$ 1,294,315**	

[1] The Custom Fixed Income benchmark is weighted 66.7% Lehman Brothers TIPS Index and 33.3% Lehman Brothers Aggregate Index.

[2] The Deposit Accumulation Fund holds the remaining active member dollars in a short term bond fund. MERF does not consider this account part of their asset allocation, therefore it is not included in the total rate of return or asset allocation.

Minneapolis Firefighters' Relief Association

For the Year Ended December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)	
OSA One-Year ROR	6.6 %
Plan One-Year ROR	5.9 %
Benchmark ROR	4.1%[1]
Actuarial Assumed ROR - Active	6.0 %
Actuarial Assumed ROR - Retired	6.0 %
OSA Three-Year ROR	12.1 %
OSA Five-Year ROR	4.1 %

Benchmark Components and Rates of Return	
S&P 500	4.9 %
Lehman Bros. Aggregate	2.4 %

Policy Asset Allocation	
Domestic Equities	40-70%
Domestic Bonds	20-40%
Real Estate and Other	0-5%

Actual Asset Allocation	
Domestic Equities	51.6 %
International Equities	9.6 %
Bonds	31.0 %
Cash	7.8 %

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 103,968	$ (48,538)	5,999	$ 61,429	6.5 %
Bonds	Bonds	31,698	6,700	827	39,225	2.5 %
International Equity	International Equity	0	25,000	(505)	24,495	(2.0)%
Cash	Cash	790	404	12	1,206	1.6 %
Misc. Real Estate	Misc. Real Estate	1,600	(1,628)	31	3	3.7 %
Alliance Bernstein (Regent)	Balanced	17,913	(34)	1,143	19,022	6.4 %
Alliance Capital Management	Balanced	65,858	(65,308)	(550)	0	(0.5)%
Ivy Global Funds	Natural Resources - Equity	0	9,214	1,380	10,594	17.5 %
Leuthold Weeden	Balanced	0	29,357	4,773	34,130	17.4 %
Mairs & Power	Balanced	0	27,186	957	28,143	3.5 %
SBI Income Share - Health Escrow	Balanced	2,220	0	110	2,330	5.0 %
US Bancorp Asset Management	Balanced	22,235	(15)	1,216	23,436	5.5 %
Voyageur Asset Management	Balanced	11,351	(10)	383	11,724	3.4 %
	Total	**$ 257,633**	**$ (17,672)**	**$ 15,776**	**$ 255,737**	

[1] 69% allocated to S&P 500 and 31% to Lehman Bros. Aggregate

Minneapolis Police Relief Association

Year Ending December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)

OSA One-Year ROR	6.0 %
Plan One-Year ROR	6.0 % [1]
Benchmark ROR	6.5 %
Actuarial Assumed ROR - Active	6.0 %
Actuarial Assumed ROR - Retired	6.0 %
OSA Three-Year ROR	12.6 %
OSA Five-Year ROR	4.2 %

Benchmark Components and Rates of Return	
Wilshire 5000	6.4 %
Lehman Bros. Aggregate	2.4 %
MSCI ACWI ex. U.S.	16.6 %

Policy Asset Allocation	
Domestic Equities	55.0 %
Fixed Income	32.0 %
International Equities	13.0 %
Other	0.0 %

Actual Asset Allocation		
Domestic Equities		43.6 %
Fixed Income		31.9 %
International Equities		13.9 %
Global Equities		9.7 %
Other		0.9 %
Cash	0.8 %	
Venture Capital	0.1 %	

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 195,740	$ (41,765)	$ 6,897	$ 160,872	4.7 %
Fixed Income	Fixed Income	104,488	9,896	3,317	117,701	3.1 %
International Equities	International Equities	47,724	(3,450)	6,856	51,130	15.1 %
Global Equities	Global Equities	0	32,650	3,344	35,994	14.1 %
Cash	Cash	108	169	8	285	3.0 %
Venture Capital	Venture Capital	778	(345)	(99)	334	(16.2)%
Healthcare Defined Contribution	Cash	2,879	(248)	104	2,735	3.9 %
	Total	**$ 351,717**	**$ (3,093)**	**$ 20,427**	**$ 369,051**	

[1] The Minneapolis Police Relief Association originally reported a one-year return of 5.9 percent. After our Office's review, the consultant for Minneapolis Police identified two errors in its calculation and revised the reported return to 6.0 percent.

Minneapolis Teachers' Retirement Fund Association

For the Year Ended December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)

OSA One-Year ROR	5.7 %
Plan One-Year ROR	5.7 %
Benchmark ROR	6.2 %
Actuarial Assumed ROR - Active	8.5 %
Actuarial Assumed ROR - Retired	8.5 %
OSA Three-Year ROR	12.7 %
OSA Five-Year ROR	2.1 %

Benchmark Components and Rates of Return		Policy Asset Allocation		Actual Asset Allocation	
Russell 3000	6.1 %	Domestic Equities	57.0 %	Domestic Equities	56.6 %
Lehman Bros. Aggregate	2.4 %	Fixed Income	25.0 %	Fixed Income	24.6 %
MSCI EAFE	13.5 %	International Equities	15.0 %	International Equities	15.6 %
90-Day U.S. Treasury Bill	3.0 %	Cash	2.0 %	Cash	2.3 %
Russell 3000	6.1 %	Alternative Investments	1.0 %	Alternative Investments	0.9 %

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 455,114	$ (54,059)	23,261	$ 424,316	5.8 %
Fixed Income	Fixed Income	180,461	0	4,449	184,910	2.5 %
International Equities	International Equities	132,238	(27,670)	12,830	117,398	12.3 %
Cash	Cash	12,567	4,119	268	16,954	2.5 %
Alternative Investments	Venture Capital	5,680	1,150	(249)	6,581	(3.8)%
	Total	**$ 786,060**	**$ (76,460)**	**$ 40,559**	**$ 750,159**	

St. Paul Teachers' Retirement Fund Association

For the Year Ended December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)	
OSA One-Year ROR	9.9 %
Plan One-Year ROR	9.9 %
Benchmark ROR	8.9 %
Actuarial Assumed ROR - Active	8.5 %
Actuarial Assumed ROR - Retired	8.5 %
OSA Three-Year ROR	16.7 %
OSA Five-Year ROR	7.0 %

Benchmark Components and Rates of Return	
S&P 500	4.9 %
Russell 2000	4.6 %
Lehman Bros. Govt/Corp	2.4 %
NCREIF Property Index	20.1 %
MSCI EAFE	13.5 %
MSCI Emerging Markets	34.0 %
Alternative Assets	23.3 %
90-Day U.S. Treasury Bill	3.1 %

Policy Asset Allocation	
Equities: Large Cap	36.0 %
Equities: Small Cap	9.0 %
Fixed Income: Domestic	19.0 %
Real Estate	8.0 %
Int'l Equities: Large Cap	21.0 %
Int'l Equities: Small Cap	4.0 %
Alternative Assets	2.0 %
Cash	1.0 %

Actual Asset Allocation	
Domestic Equities	46.1 %
Domestic Fixed Income	17.4 %
Real Estate	8.5 %
International Equities	26.8 %
Alternative Assets	0.5 %
Cash	0.7 %

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 482,714	$ (66,750)	$ 37,654	$ 453,618	8.9 %
Domestic Fixed Income[1]	Domestic Fixed Income	172,870	(7,000)	4,627	170,497	2.7 %
International Equities	International Equities	211,246	19,530	32,729	263,505	14.5 %
Real Estate	Real Estate	57,292	13,000	13,529	83,821	19.2 %
Alternative Investments	Alternative	3,582	709	964	5,255	23.3 %
Cash	Cash	6,380	489	59	6,928	2.3 %
	Total	**$ 934,084**	**$ (40,022)**	**$ 89,562**	**$ 983,624**	

[1] SPTRFA reported an increase of $1.6 million in the beginning market value of Domestic Fixed Income. The adjustment was needed because total holdings in the asset class were underreported in the previous reporting year.

State Board of Investment - Basic Fund

For the Year Ended December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)

Plan One-Year ROR	10.2 %
Benchmark ROR	10.1 %
Actuarial Assumed ROR - Active	8.5 %
Plan Three-Year ROR	15.2 %
Plan Five-Year ROR	4.7 %

Benchmark Components and Rates of Return	
Russell 3000	6.1 %
Lehman Bros. Aggregate	2.4 %
MSCI ACWI ex. U.S	16.6 %
Alternative Assets [1]	44.8 %
90-Day U.S. Treasury Bill	3.2 %

Policy Asset Allocation	
Domestic Equities	45.0 %
Bonds	24.0 %
International Equities	15.0 %
Alternative Assets	15.0 %
Cash	1.0 %

Actual Asset Allocation	
Domestic Equities	50.3 %
Bonds	22.1 %
International Equities	16.3 %
Alternative Assets	10.4 %
Cash	0.9 %

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 10,279,504	$ 40,052	$ 659,320	$ 10,978,877	6.4 %
Bonds	Bonds	4,401,618	297,738	128,363	4,827,720	2.7 %
International Equities	International Equities	3,357,310	(298,970)	491,479	3,549,820	16.3 %
Alternatives	Alternative Assets	1,901,078	(371,733)	741,206	2,270,551	44.8 %
Cash & Disbursement Account	Cash	261,349	(79,020)	6,509	188,838	3.2 %
Miscellaneous Expense Account		0	312	(312)	0	0.0 %
	Total	**$ 20,200,861**	**$ (411,620)**	**$ 2,026,567**	**$ 21,815,809**	

[1] Actual rate of return is used as the benchmark for Alternative Assets.

State Board of Investment - Post Fund

For the Year Ended December 31, 2005

(Dollars in Thousands)

Rates of Return (ROR)	
Plan One-Year ROR	9.6 %
Benchmark ROR	9.4 %
Actuarial Assumed ROR - Retired [1]	8.5 %
Plan Three-Year ROR	14.8 %
Plan Five-Year ROR	4.9 %

Benchmark Components and Rates of Return	
Russell 3000	6.1 %
Lehman Bros. Aggregate	2.4 %
MSCI ACWI ex. U.S.	16.6 %
Alternative Assets [2]	44.8 %
90-Day U.S. Treasury Bill	3.2 %

Policy Asset Allocation	
Domestic Equities	45.0 %
Bonds	25.0 %
International Equities	15.0 %
Alternative Assets	12.0 %
Cash	3.0 %

Actual Asset Allocation	
Domestic Equities	51.1 %
Bonds	23.5 %
International Equities	16.6 %
Alternative Assets	8.5 %
Cash	0.3 %

Asset Class	Investment Type	Beginning Market Value	Net Cash Flow (Net of Fees)	Investment Return	Ending Market Value	Rate of Return
Domestic Equities	Domestic Equities	$ 9,780,076	$ (31,836)	$ 621,819	$ 10,370,059	6.4 %
Bonds	Bonds	4,464,733	183,511	126,243	4,774,488	2.8 %
International Equities	International Equities	3,266,920	(377,974)	471,831	3,360,777	16.5 %
Alternatives	Alternative Assets	1,475,900	(320,623)	565,382	1,720,658	44.8 %
Cash & Disbursement Account	Cash	491,804	(432,422)	9,901	69,282	3.2 %
Miscellaneous Expense Account		0	1,146	(1,146)	0	0.0 %
	Total	**$ 19,479,433**	**$ (978,200)**	**$ 1,794,032**	**$ 20,295,266**	

[1] The Actuarial Assumed Rate of Return is comprised of a statutory 6.0% plus a guaranteed CPI-based COLA capped at 2.5%.

[2] Actual rate of return is used as the benchmark for Alternative Assets.

2005 Appendix Tables

Table 1

Historical Rates of Return

For Calendar Years 1997 to 2005

Public Pension Plans	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Bloomington Fire	19.7 %	13.8 %	13.2 %	(3.9) %	(7.9) %	(14.4) %	19.4 %	9.5 %	4.7 %
Duluth Teachers'	15.7	11.1	29.4	(1.6)	(4.3)	(12.6)	28.2	10.6	7.6
MERF	18.5	15.7	15.5	(1.3)	(6.1)	(11.4)	23.8	12.8	7.3
Minneapolis Fire	23.4	21.9	17.8	(2.7)	(3.3)	(10.0)	20.0	10.1	6.6
Minneapolis Police	12.8	11.4	11.1	(2.0)	(4.1)	(10.1)	22.3	10.1	6.0
Minneapolis Teachers'	15.5	14.2	21.5	(6.0)	(7.7)	(16.1)	22.8	10.2	5.7
St. Paul Teachers'	19.3	12.1	13.6	(0.2)	(1.7)	(10.1)	26.7	14.1	9.9
SBI Income Share	23.4	17.3	14.3	(2.3)	(3.8)	(10.9)	19.8	9.2	5.0

Table 2-A

State of Minnesota Contributions

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ 340,683	$ 355,234	$ 360,549	$ 370,100	$ 363,938	$ 411,764	$ 495,967	$ 625,566	$ 585,966
Duluth Teachers' (6/30)	-	486,000	486,000	486,000	486,000	486,000	-	-	-
MERF (6/30)	11,056,266	11,014,812	7,557,403	3,595,647	3,707,729	3,232,000	6,632,000	7,093,000	8,064,635
Minneapolis Fire (12/31)	1,219,587	1,250,754	456,956	783,880	905,282	1,024,112	1,328,901	2,146,934	1,913,951
Minneapolis Police (12/31)	3,630,557	3,431,684	3,021,373	3,268,063	3,448,383	5,413,835	5,879,854	7,089,022	6,573,582
Minneapolis Teachers' (6/30)	3,572,588	22,026,586	17,128,775	17,183,077	17,166,223	16,408,795	16,791,942	16,771,302	16,764,411
St. Paul Teachers' (6/30)	1,023,327	5,508,853	3,551,225	3,572,726	3,572,726	3,257,761	3,383,761	3,392,761	3,397,761
Total	**$ 20,843,008**	**$ 44,073,923**	**$ 32,562,281**	**$ 29,259,493**	**$ 29,650,281**	**$ 30,234,267**	**$ 34,512,425**	**$ 37,118,585**	**$ 37,300,306**

Note: This table includes any amount from the State of Minnesota regardless of where it is reported in the financial statements. (e.g. as part of Employer Contributions).

Table 2-B

Total Employer Contributions

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ 480,900	$ -	$ -	$ -	$ -	$ -	$ 742,343	$ 2,986,280	$ 1,576,139
Duluth Teachers' (6/30)	2,708,473	2,724,719	3,020,978	3,026,454	3,010,595	2,955,816	2,933,172	2,826,730	2,845,684
MERF (6/30)	18,586,141	18,143,276	14,722,996	13,013,923	11,233,852	12,260,956	38,102,470	38,366,011	11,330,441
Minneapolis Fire (12/31)	3,725,237	4,316,760	720,376	1,154,484	326,969	5,907	4,270	2,670	4,737,705
Minneapolis Police (12/31)	3,907,944	2,698,561	698,080	1,295,071	10,812	2,912,060	13,540,305	20,800,530	24,976,747
Minneapolis Teachers' (6/30)	20,448,819	21,613,713	23,357,250	25,373,644	25,738,703	25,696,261	25,394,648	24,231,782	22,782,933
St. Paul Teachers' (6/30)	15,019,989	16,192,817	17,514,764	19,049,291	19,996,142	20,958,423	19,986,168	20,378,315	20,435,230
Total	**$ 64,877,503**	**$ 65,689,846**	**$ 60,034,444**	**$ 62,912,867**	**$ 60,317,073**	**$ 64,789,423**	**$ 100,703,376**	**$ 109,592,318**	**$ 88,684,879**

***NOTE:** This table includes all city contributions where the city is the employer. The total Employer Contributions is calculated by adding the Employer Regular and Special Contributions together. Some of the above entities include State of Minnesota Contributions as Employer Contributions for Financial Reporting purposes. No State of Minnesota contributions are reported on this table.

Table 2-C

Total Employee Contributions

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ 20,148	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Duluth Teachers' (6/30)	2,643,760	2,663,937	3,118,271	3,152,295	3,141,228	3,275,405	3,298,902	2,991,801	2,924,264
MERF (6/30)	7,344,829	6,784,928	6,937,655	6,069,060	5,368,087	4,779,661	4,167,298	3,342,960	3,086,571
Minneapolis Fire (12/31)	954,264	436,751	316,986	295,016	133,031	149,260	136,209	39,852	12,010
Minneapolis Police (12/31)	971,632	387,703	188,474	166,325	56,995	20,620	3,815	-	-
Minneapolis Teachers' (6/30)	11,696,476	13,852,469	14,924,647	16,168,629	16,321,023	17,715,111	16,672,305	15,461,562	13,820,754
St. Paul Teachers' (6/30)	9,484,154	11,056,660	11,648,657	13,183,734	13,152,552	14,467,695	14,222,154	14,307,616	13,586,719
Total	**$ 33,115,263**	**$ 35,182,448**	**$ 37,134,690**	**$ 39,035,059**	**$ 38,172,916**	**$ 40,407,752**	**$ 38,500,683**	**$ 36,143,791**	**$ 33,430,318**

Table 2-D

Average Total Contributions by Total Members

For Fiscal Years 1997 to 2005

Public Pension Plans	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Bloomington Fire (12/31)	$ 3,176	$ 1,330	$ 1,321	$ 1,272	$ 1,197	$ 1,363	$ 4,309	$ 12,567	$ 7,558
Duluth Teachers' (6/30)	1,764	1,917	2,102	2,093	2,008	1,956	1,784	1,776	1,766
MERF (6/30)	5,384	5,367	4,457	3,537	3,269	3,347	8,354	8,541	4,055
Minneapolis Fire (12/31)	7,337	7,581	1,926	2,946	1,868	1,656	2,130	3,302	10,445
Minneapolis Police (12/31)	7,894	6,069	3,729	4,619	3,488	8,482	20,254	29,701	34,257
Minneapolis Teachers' (6/30)	3,727	5,611	5,098	5,010	4,787	4,607	4,439	4,193	3,931
St. Paul Teachers' (6/30)	3,826	4,389	4,193	4,148	4,094	4,076	3,921	3,864	3,776

Note: This is calculated by dividing Total Contributions by the Total number of members.

Table 3

Average of Total Benefits Payments by Retired Member/Beneficiary

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ 14,107	$ 14,399	$ 14,738	$ 16,516	$ 16,906	$ 17,343	$ 19,095	$ 18,880	$ 19,744
Duluth Teachers' (6/30)	10,012	10,845	11,834	12,499	13,719	14,815	15,365	15,309	15,931
MERF (6/30)	17,038	18,097	19,453	21,382	24,008	26,124	27,171	27,669	28,681
Minneapolis Fire (12/31)	30,242	27,722	35,685	35,836	37,683	37,956	31,666	35,070	35,141
Minneapolis Police (12/31)	29,058	26,708	28,284	33,222	32,655	33,108	34,070	35,611	37,378
Minneapolis Teachers' (6/30)	20,570	22,295	24,305	26,286	28,867	31,061	31,389	31,657	32,352
St. Paul Teachers' (6/30)	15,781	21,391	22,805	24,283	26,439	27,835	28,618	29,174	29,349

[1] The St. Paul Teachers amount for 1997 is artificially low because the Pension Uniformity legislation passed in 1997 made several substantive changes in the benefits for participants in this plan. These changes included the fundamental structural change in post-retirement benefit adjustments from the old “13th check” approach to the new “2 percent plus excess earnings” approach. The final 13th check was recognized as a payable in 1996. Benefits increased significantly during 1998 because of incentives from the School District to retire before January 1, 1998 (reduced post-retirement health benefits after that date) and a 7 percent increase on pension bases on January 1, 1998, due to the Pension Uniformity legislation passed in 1997 regarding the 13th check approach.

Note: Beneficiaries include Retirees, Disabled members and Surviving Spouse.

Table 4

Percent Increase in Average of Total Benefits Payments by Retired Member/Beneficiary and The Consumer Price Index

For Fiscal Years 1997 to 2005

Public Pension Plans	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Consumer Price Index	N/A	1.60 %	2.20 %	3.40 %	2.80 %	1.60 %	2.30 %	2.70 %	3.40 %
Bloomington Fire (12/31)	N/A	2.07	2.35	12.07	2.36	2.58	10.10	(1.13)	4.57
Duluth Teachers' (6/30)	N/A	8.32	9.12	5.62	9.76	7.99	3.71	(0.36)	4.06
MERF (6/30)	N/A	6.22	7.49	9.92	12.28	8.82	4.00	1.83	3.66
Minneapolis Fire (12/31)	N/A	(8.33)	28.73	0.42	5.15	0.73	(16.57)	10.75	0.20
Minneapolis Police (12/31)	N/A	(8.09)	5.90	17.46	(1.71)	1.39	2.91	4.52	4.96
Minneapolis Teachers' (6/30)	N/A	8.39	9.01	8.15	9.82	7.60	1.05	0.85	2.20
St. Paul Teachers' (6/30) [1]	N/A	35.55	6.61	6.48	8.88	5.28	2.81	1.94	0.60

[1] The St. Paul Teachers amount for 1997 is artificially low because the Pension Uniformity legislation passed in 1997 made several substantive changes in the benefits for participants in this plan. These changes included the fundamental structural change in post-retirement benefit adjustments from the old “13th check” approach to the new “2 percent plus excess earnings” approach. The final 13th check was recognized as a payable in 1996. Benefits increased significantly during 1998 because of incentives from the School District to retire before January 1, 1998 (reduced post-retirement health benefits after that date) and a 7 percent increase on pension bases on January 1, 1998, due to the Pension Uniformity legislation passed in 1997 regarding the 13th check approach.

Note: Beneficiaries include Retirees, Disabled members and Surviving Spouse.

Table 5

Funded Ratio Percentage

For Fiscal Years 1997 to 2005

Public Pension Plans	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Bloomington Fire (12/31)	148.06 %	152.51 %	164.75 %	144.12 %	123.57 %	96.42 %	110.21 %	115.12 %	124.16 %
Duluth Teachers' (6/30)	86.00	95.10	99.20	103.80	107.60	100.40	95.70	91.80	86.40
MERF (6/30)	84.00	89.00	93.00	93.00	93.00	92.00	92.00	92.00	92.00
Minneapolis Fire (12/31)	89.50	105.40	109.20	107.50	103.90	87.20	80.60	90.20	86.20
Minneapolis Police (12/31)	91.00	93.40	95.40	87.50	75.10	66.80	64.50	68.60	77.30
Minneapolis Teachers' (6/30)	57.37	63.91	67.38	66.54	65.95	61.94	56.85	50.75	44.61
St. Paul Teachers' (6/30)	69.11	72.55	75.01	80.32	81.91	78.82	75.57	71.82	69.65

Note: This calculation is the result of dividing the Actuarial Value of Plan Assets by the Actuarial Accrued Liability.

Table 6

Total Actuarial Accrued Unfunded Liability

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ (28,507,608)	$ (34,053,283)	$ (43,264,741)	$ (31,750,789)	$ (17,924,916)	$ 2,914,369	$ (8,516,589)	$ (13,307,091)	$ (20,457,329)
Duluth Teachers' (6/30)	27,761,000	9,596,000	1,842,000	(9,108,000)	(19,363,000)	(1,087,000)	12,642,000	24,755,000	42,443,000
MERF (6/30)	202,657,000	143,618,000	106,487,000	99,472,000	108,813,000	127,650,000	126,500,000	129,751,133	134,641,560
Minneapolis Fire (12/31)	28,724,000	(15,276,000)	(26,875,000)	(22,098,000)	(11,491,000)	37,484,000	56,964,000	26,967,000	43,137,000
Minneapolis Police (12/31)	36,045,000	27,164,000	20,474,000	56,003,000	115,479,000	153,820,000	165,122,000	147,279,000	105,190,000
Minneapolis Teachers' (6/30)	500,203,000	457,446,000	454,898,000	516,725,000	548,381,000	631,629,000	715,069,000	851,787,000	972,559,000
St. Paul Teachers' (6/30)	248,660,000	236,531,000	234,614,000	196,430,000	191,886,000	241,728,000	290,601,000	352,600,000	394,539,000
Total	**$ 1,015,542,392**	**$ 825,025,717**	**$ 748,175,259**	**$ 805,673,211**	**$ 915,780,084**	**$ 1,194,138,369**	**$ 1,358,381,411**	**$ 1,519,832,042**	**$ 1,672,052,231**

Table 7-A

Net Assets Held in Trust for Pension Benefits

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ 88,415,033	$ 98,936,155	$ 110,130,150	$ 104,088,281	$ 93,960,664	$ 78,447,410	$ 91,904,997	$ 101,341,890	$ 105,139,140
Duluth Teachers' (6/30)	199,442,263	225,756,504	243,211,001	298,838,376	266,702,972	234,368,916	231,247,693	258,831,515	267,383,556
MERF (6/30)	1,323,749,756	1,494,135,875	1,596,623,979	1,667,011,994	1,463,731,615	1,250,320,810	1,194,940,521	1,282,717,353	1,288,106,030
Minneapolis Fire (12/31)	264,720,900	309,919,667	341,239,285	310,820,185	276,816,112	226,580,974	250,351,289	254,086,792	254,424,228
Minneapolis Police (12/31)	372,895,470	392,306,987	413,332,413	376,849,745	332,847,764	277,143,300	323,467,991	348,910,983	366,406,914
Minneapolis Teachers' (6/30)	796,275,892	907,331,934	1,000,241,426	1,099,515,863	932,398,241	770,489,009	719,598,888	763,089,276	745,214,858
St. Paul Teachers' (6/30)	647,249,634	744,660,838	801,954,037	873,227,927	824,224,957	768,931,641	757,639,499	871,902,589	934,667,364
Total	**$ 3,692,748,948**	**$ 4,173,047,960**	**$ 4,506,732,291**	**$ 4,730,352,371**	**$ 4,190,682,325**	**$ 3,606,282,060**	**$ 3,569,150,878**	**$ 3,880,880,398**	**$ 3,961,342,090**

Note: These Net Assets only include any net assets that are "Held in Trust for Pension Benefits".

Table 7-B

Average Total Net Assets by Total Members

For Fiscal Years 1997 to 2005

Public Pension Plans	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Bloomington Fire (12/31)	$ 333,642	$ 370,547	$ 403,407	$ 357,692	$ 309,081	$ 259,760	$ 314,743	$ 350,664	$ 363,803
Duluth Teachers' (6/30)	65,736	73,656	77,161	93,856	80,672	68,230	66,203	78,984	81,819
MERF (6/30)	192,686	223,105	243,573	260,024	235,630	206,426	204,124	224,487	232,342
Minneapolis Fire (12/31)	329,255	391,313	439,741	410,053	378,681	318,232	362,828	383,238	398,784
Minneapolis Police (12/31)	345,914	365,277	394,401	368,017	330,206	281,650	337,297	371,577	397,836
Minneapolis Teachers' (6/30)	83,093	88,555	92,019	93,807	75,357	59,332	54,272	56,672	54,892
St. Paul Teachers' (6/30)	97,010	99,767	102,775	101,162	91,897	81,017	79,028	88,482	94,325

Note: This calculation is the result of dividing the Total Net Assets by the Total Members.

Table 8

Average Actuarial Accrued Unfunded Liability by Total Members

For Fiscal Years 1997 to 2005

Public Pension Plans	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Bloomington Fire (12/31)	$ (107,576)	$ (127,540)	$ (158,479)	$ (109,109)	$ (58,964)	$ 9,650	$ (29,166)	$ (46,045)	$ (70,787)
Duluth Teachers' (6/30)	9,150	3,131	584	(2,861)	(5,857)	(316)	3,619	7,554	12,987
MERF (6/30)	29,499	21,445	16,245	15,516	17,517	21,075	21,609	22,708	24,286
Minneapolis Fire (12/31)	35,726	(19,288)	(34,633)	(29,153)	(15,720)	52,646	82,557	40,674	67,613
Minneapolis Police (12/31)	33,437	25,292	19,536	54,690	114,563	156,321	172,181	156,847	114,213
Minneapolis Teachers' (6/30)	52,197	44,646	41,849	44,085	44,321	48,639	53,931	63,259	71,638
St. Paul Teachers' (6/30)	37,269	31,690	30,067	22,756	21,394	25,469	30,312	35,782	39,816

Note: This calculaton is the result of dividing the Total Actuarial Accrued Unfunded Liability by the Total Members.

Table 9

Total Administrative Expenses

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ 50,393	$ 77,009	$ 122,456	$ 75,548	$ 79,303	$ 83,633	$ 75,953	$ 64,223	$ 64,844
Duluth Teachers' (6/30)	311,379	340,503	358,032	400,516	419,807	447,584	444,810	448,704	436,507
MERF (6/30)	1,016,740	922,706	858,663	742,134	699,869	748,180	737,200	717,952	731,566
Minneapolis Fire (12/31)	513,812	635,362	1,097,438	1,005,294	709,643	707,462	615,867	577,336	668,027
Minneapolis Police (12/31)	546,854	1,294,783	1,331,532	1,241,787	1,095,313	874,230	582,371	769,566	589,491
Minneapolis Teachers' (6/30)	519,638	526,756	531,938	587,328	671,516	711,486	804,173	730,890	721,099
St. Paul Teachers' (6/30)	407,004	393,992	417,041	447,459	443,745	451,749	473,934	515,716	558,574
Total	**$ 3,365,820**	**$ 4,191,111**	**$ 4,717,100**	**$ 4,500,066**	**$ 4,119,196**	**$ 4,024,324**	**$ 3,734,308**	**$ 3,824,387**	**$ 3,770,108**

Note: This page is the compilation of the Administrative Expense breakdown pages, Personnel Services, Legal Fees, Professional Services, and the Other Administrative Expenses. (e.g. Personnel, General, and Professional)

Table 10

Average Total Administrative Expense by Total Members

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	$ 190	$ 288	$ 449	$ 260	$ 261	$ 277	$ 260	$ 222	$ 224
Duluth Teachers' (6/30)	103	111	114	126	127	130	127	137	134
MERF (6/30)	148	138	131	116	113	124	126	126	132
Minneapolis Fire (12/31)	639	802	1,414	1,326	971	994	893	871	1,047
Minneapolis Police (12/31)	507	1,206	1,271	1,213	1,087	888	607	820	640
Minneapolis Teachers' (6/30)	54	51	49	50	54	55	61	54	53
St. Paul Teachers' (6/30)	61	53	53	52	49	48	49	52	56

Table 11-A

Total Members at Fiscal Year End

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31)	265	267	273	291	304	302	292	289	289
Duluth Teachers' (6/30)	3,034	3,065	3,152	3,184	3,306	3,435	3,493	3,277	3,268
MERF (6/30)	6,870	6,697	6,555	6,411	6,212	6,057	5,854	5,714	5,544
Minneapolis Fire (12/31)	804	792	776	758	731	712	690	663	638
Minneapolis Police (12/31)	1,078	1,074	1,048	1,024	1,008	984	959	939	921
Minneapolis Teachers' (6/30)	9,583	10,246	10,870	11,721	12,373	12,986	13,259	13,465	13,576
St. Paul Teachers' (6/30)	6,672	7,464	7,803	8,632	8,969	9,491	9,587	9,854	9,909
Total	**28,306**	**29,605**	**30,477**	**32,021**	**32,903**	**33,967**	**34,134**	**34,201**	**34,145**

Note: Total Members is the sum of the Retired/Beneficiary, Terminated and the Current tables.

Table 11-B

Members at Fiscal Year End-Retirees & Beneficiaries Receiving Benefits

For Fiscal Years 1997 to 2005

Public Pension Plans	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bloomington Fire (12/31) *	121	127	134	129	133	141	139	147	149
Duluth Teachers' (6/30)	879	910	939	996	1,058	1,085	1,107	1,137	1,153
MERF (6/30)	4,950	4,908	4,950	5,026	5,043	5,021	4,960	4,981	4,908
Minneapolis Fire (12/31)	603	611	622	653	645	634	630	621	601
Minneapolis Police (12/31)	878	920	917	924	933	928	935	921	904
Minneapolis Teachers' (6/30)	2,873	3,024	3,145	3,307	3,444	3,545	3,642	3,764	3,839
St. Paul Teachers' (6/30)	1,720	1,789	1,860	1,964	2,050	2,136	2,248	2,361	2,505
Total	**12,024**	**12,289**	**12,567**	**12,999**	**13,306**	**13,490**	**13,661**	**13,932**	**14,059**

* For the years of 1997 through 1999, Terminated Members, if any, includes Terminated entitled to benefits but not yet receiving benefits.

Note: Beneficiaries are defined as Retirees, Disabled Members, and Surviving Spouse.

Table 12

Total Investment Expenses

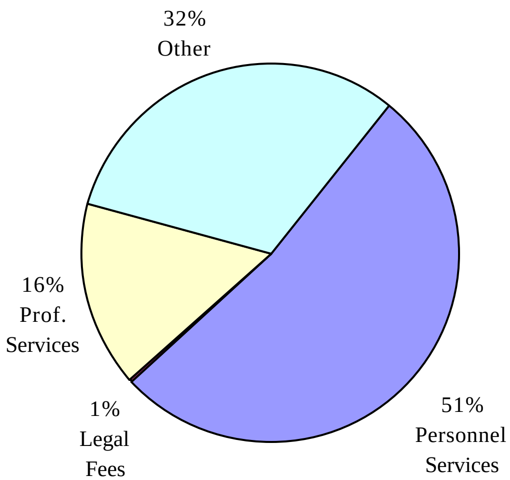
For Fiscal Years 1997 to 2005

Public Pension Plans	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Bloomington Fire (12/31)	$ 47,520	$ 96,880	$ 119,818	$ 175,100	$ 182,228	$ 161,551	$ 64,744	$ 78,689	$ 86,305
Duluth Teachers' (6/30)	856,693	880,274	1,050,669	1,391,248	1,190,624	1,237,863	959,000	1,203,295	1,169,704
MERF (6/30)	4,059,985	3,116,611	4,299,061	4,869,352	5,179,031	4,190,896	3,252,744	3,885,872	3,635,973
Minneapolis Fire (12/31)	870,421	1,286,779	802,971	681,756	606,936	1,093,627	1,001,354	1,042,816	1,088,434
Minneapolis Police (12/31)	1,315,575	1,397,182	1,022,262	1,782,611	1,287,191	1,150,027	932,425	922,855	645,622
Minneapolis Teachers' (6/30)	2,913,008	2,972,585	2,774,627	4,082,679	3,494,217	2,804,119	2,106,092	2,406,831	2,518,116
St. Paul Teachers' (6/30)	2,046,392	2,339,075	2,140,919	2,664,417	2,769,233	2,656,216	2,774,231	3,059,912	3,422,410
Total	**$ 12,109,594**	**$ 12,089,386**	**$ 12,210,327**	**$ 15,647,163**	**$ 14,709,460**	**$ 13,294,299**	**$ 11,090,590**	**$ 12,600,270**	**$ 12,566,564**

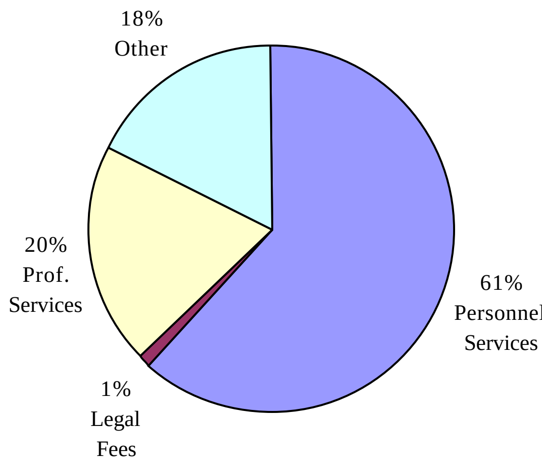
Note: Investment Expenses exclude Securities Lending.

Table 13

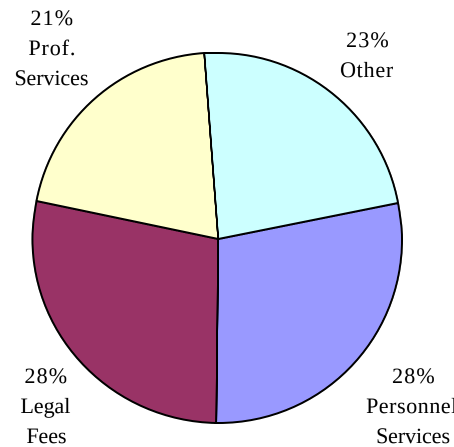
Administrative Expenses for Fiscal Year 2005



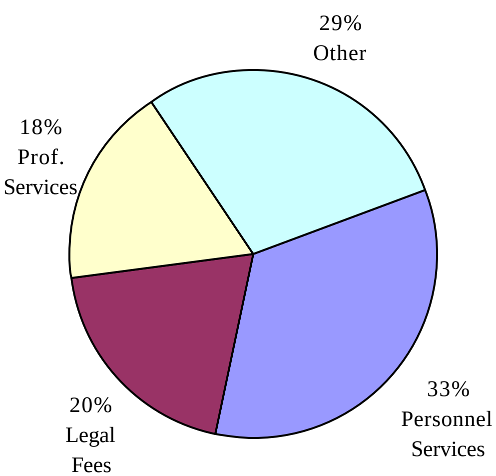
Duluth Teachers' - $436,507



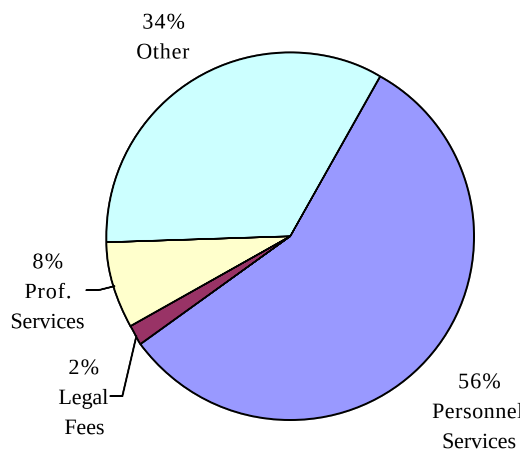
MERF - $731,566



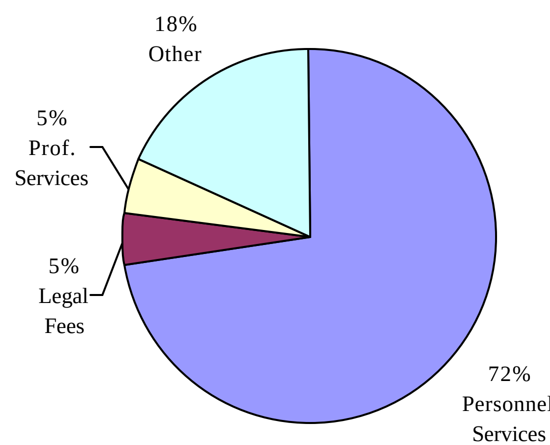
Minneapolis Fire - $668,027



Minneapolis Police - $589,491



Minneapolis Teachers' - $721,099



Saint Paul Teachers' - $558,574

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