05 - 0088

merf

Minneapolis Employees Retirement Fund

Comprehensive Annual Financial Report

For the Fiscal Year Ended June 30, 2004

Minneapolis, Minnesota

Minneapolis Employees Retirement Fund

800 Baker Building
706 – 2nd Avenue South
Minneapolis, Minnesota 55402

COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2004

REPORT PREPARED BY:
MERF STAFF UNDER DIRECTION OF THE ACCOUNTING DEPARTMENT

TABLE OF CONTENTS

PAGE

INTRODUCTORY SECTION

FINANCIAL SECTION

INVESTMENT SECTION

ACTUARIAL SECTION

STATISTICAL SECTION

CERTIFICATE OF ACHIEVEMENT

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Minneapolis Employees Retirement Plan

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2003

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

President

Executive Director

LETTER OF TRANSMITTAL

November 12, 2004

Board of Directors
Minneapolis Employees Retirement Fund
800 Baker Building
706 2nd Avenue South
Minneapolis, Minnesota 55402

Minneapolis Employees Retirement Fund

800 Baker Building
706 - 2nd Avenue South
Minneapolis, MN 55402-3004
(612) 335-5950
FAX (612) 335-5940

Judith M. Johnson
Executive Director/
Chief Investment Officer

Dear Board Member:

The comprehensive annual financial report (CAFR) of the Minneapolis Employees Retirement Fund (MERF) for the fiscal year ended June 30, 2004 is submitted herewith. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the management of MERF. The CAFR is divided into five sections:

- **Introductory Section**, which contains the Certificate of Achievement for Excellence in Financial Reporting, a letter of transmittal and the administrative organization;
- **Financial Section**, which contains the report of the independent auditors, the management's discussion and analysis (MD&A), the financial statements of MERF and certain required supplementary information. The MD&A is designed to complement the letter of transmittal and should be read in conjunction with it.
- **Investment Section**, which contains a report on investment activity, investment policies, investment results and various investment schedules;
- **Actuarial Section**, which contains an Actuary's Certification Letter and the results of the annual actuarial valuation; and
- **Statistical Section**, which includes significant data pertaining to MERF.

MERF was established in 1919 by the Minnesota State Legislature to provide members with survivor and disability protection during employment and financial security after retirement. MERF is a cost-sharing multiple employer plan. Participating employers include the City of Minneapolis, Minneapolis Special School District No. 1, Minneapolis-St. Paul Metropolitan Airports Commission, Metropolitan Council/Environmental Services, Minnesota State Colleges and Universities and Hennepin County.

This CAFR was prepared to conform with the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board. Transactions of the plan are reported on the accrual basis of accounting. MERF management is responsible for establishing and maintaining internal controls designed to ensure that assets are protected from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with Generally Accepted Accounting Principles. Internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management. It is the opinion of management that sufficient internal accounting controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements, supporting schedules and statistical tables.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to MERF for its CAFR for the fiscal year ended June 30, 2003. This was the 21th consecutive year that MERF has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

LETTER OF TRANSMITTAL (CONTINUED)

November 12, 2004
Page Two

Plan Financial Condition
Participants, employers and taxpayers have a vital interest in the funding level of a plan. In all cases the financial soundness of the plan is reflected in the funding level. In the case of MERF, where the plan is a terminal plan that has been closed to new members since 1978, maintaining and improving the funding level is critically important. As the percentage of the liabilities that are in present benefit status increases in such a plan, it is necessary to have assets in the plan to earn sufficient income to generate the returns to pay these benefits. The loss of active member workforce through retirements effectively lowers the contribution revenue into the plan each year. The employer contributions and earnings must make up the difference to satisfy both the annual benefit payments and future benefit payments.

MERF's two benefit paying sub-funds had outstanding investment returns for the year. The retired fund earned 16.86%, the survivor and disability fund earned 16.09% and the deposit accumulation fund earned 0.79%. The deposit accumulation fund is invested for the short term in a short-term bond fund, as all of the assets are expected to be expended by 2006. MERF's funding level still declined from 92.31% to 92.10%. In large part this was due to actuarial recognition of losses from the bear market of the previous three years over a five year time cycle. There is a total of $28.04 million of remaining losses to be recognized in the coming years.

The percentage of assets (measured on a market value basis) devoted to MERF's subfunds that are currently paying benefits to members within the subfunds total 95.22%. Fully 87.53% of the assets are dedicated to the retired benefit fund. The remaining 7.69% of benefit paying assets are dedicated to the survivor's and disabled fund. This leaves just 4.78% of assets available that are dedicated to the pension obligations of the current active workforce.

MERF has developed an "end game" which is a necessary strategy for the final funding of a pension plan that has a remaining expected life of its active workforce of under ten years. It is expected that almost all of the remaining active workforce of 552 members will retire by 2013. Under Minnesota law, the present value of an active member's entire expected pension payments must be transferred from the deposit accumulation fund to the retired fund at the end of the month that a person retires. Thus, when the last member retires it is expected that there will be no assets in the deposit accumulation fund and the MERF fund will hold all of its assets in the three sub-funds (survivor, disability, and retired).

Minnesota law also provides that the employer is not financially responsible for additional contributions to any of the three benefit paying sub-funds except to fund any RBF transfer which the actuary calculates on an annual basis, and MERF charges directly to the account balance of each employer. It is therefore the case that as active members retire MERF's employer-contributors have less exposure to future pension contributions as they no longer bear the investment risk for the transferred assets.

The MERF plan has additional state governing law protection to insure that the employers provide additional funding in the event that the actuarial funding requirements are not sufficient to insure that the employer has sufficient assets in the employer's account to allow the transfer of the necessary assets when a member retires. At the end of MERF's 2004 year the City of Minneapolis had a negative account balance on a market value basis in its account. MERF's state law requires MERF to bill the employer for any funds necessary to replenish the employer accounts so that MERF can transfer the assets at retirement.

The City has issued taxable pension obligation bonds twice since June 30, 2002. These bonds become mature in 20 years and effectively enable the city to extinquish its pension obligations with MERF and to spread the repayment of the bonds over a longer time frame. The City again has a negative account balance as of the end of June 30, 2004.

While the Metropolitan Airports Commission had a negative account balance as of June 30, 2003, the negative balance was paid and the Metropolitan Airports Commission had a positive balance as of June 30, 2004. The Airports Commission has set aside funds in a reserve account to insure that it can promptly pay any further negative balances as they occur in the future.

November 12, 2004
Page Three

The School District again had a negative account balance as of June 30, 2004 as it did as of June 30, 2003. The District has hired a bond consultant and has pursed legislation that will allow the District to issue bonds to fund both the current deficit in its account and future deficits. The legislative session ended in stalemate and the enabling legislation was not passed. The District anticipates no difficulty in passing the necessary language by June 2005 and will then issue bonds to satisfy the negative balance.

In early June 2004 the City appointed a Blue Ribbon Panel of experts to study alternative ways to satisfy the pension funding needs of MERF, the Minneapolis Police Fund and the Minneapolis Fire Fund. This panel issued recommendations on October 19, 2004. The City council will then determine a preferable outcome which might include removal of MERF's liquidity triggers. MERF has determined that extension of the time to make all contributions until 2020 will not have a material impact on the financial solvency of the fund.

State contributions to the fund increase annually when the value of unfunded liability increases and decreases when there is a decline in total unfunded liability. It is expected that total state contributions available to the fund will decrease annually in future years and be eliminated entirely by 2012. The State dollars are provided pursuant to an actuarial calculation which determines the additional contribution revenue necessary to fully fund the plan by 2020. Additional information regarding the financial condition of the pension plan can be found in the Financial and Actuarial Sections of this report.

Investments Policy

MERF's investment policy is subject to the general fiduciary standards found at Minnesota Statute 356A, the Public Pension Fiduciary Responsibility Act. This act contains many of the requirements and safeguards that are found in E.R.I.S.A, a federal law that governs the fiduciary conduct of private corporate plans. In addition, MERF is subject to general common law standards that are commonly referred to as the prudent person rule.

MERF's investment policy is in writing and reflects the requirement that the assets be invested across a diversified spectrum which minimizes the risk to the plan. Due to MERF's shorter time horizon the fund prohibits investments in asset classes that do not have daily pricing and ready liquidity. Thus investments in such categories as venture capital, hedge funds, direct real estate or real estate partnerships are prohibited.

MERF policy forbids internal staff direct management of plan assets. Professional investment asset managers are selected to manage all of MERF's investments. MERF serves in an oversight role to ensure that investment guidelines are followed and appropriate returns are generated. MERF employs a professional investment consultant on a full retainer basis to further insure that that the assets are safeguarded and appropriate investment allocation is maintained to insure that an appropriate return is earned and an appropriate level of risk is maintained. Additional information about MERF's investments can be found in the Investment Section of this report.

Investment Activity

MERF's consultant prepares a detailed asset liability study every five years. This study includes recommendations to the MERF Board related to suggested enhancements and changes to MERF's Investment Policy. In conjunction with its consultant, MERF's Board undertook the study of these recommendations beginning in February 2003. As of February 2004, all the consultant's recommendations had been implemented.

Additional information about MERF's investment managers and their respective investment returns both individually and as a whole can be found in the Investment Section of this report.

LETTER OF TRANSMITTAL (CONTINUED)

November 12, 2004
Page Four

Professional Services
Professional consultants are appointed by the Board of Directors to perform professional services that are essential to the effective and efficient operation of the plan. An Opinion letter from the independent auditor is included in this report. A certification letter from the state-appointed actuary is also included in this report. The consultants appointed by the Board are listed on page 10.

Acknowledgments
The compilation of this report reflects the combined effort of MERF's staff, under the leadership of the Board of Directors. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions and as a means of determining responsible stewardship of the assets of the plan.

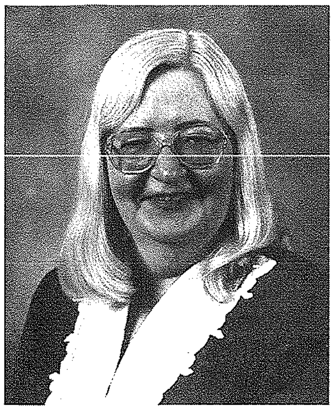
I would like to take this opportunity to express my gratitude to the staff, the consultants, and to the many people whose efforts made this report possible.

Respectfully submitted,

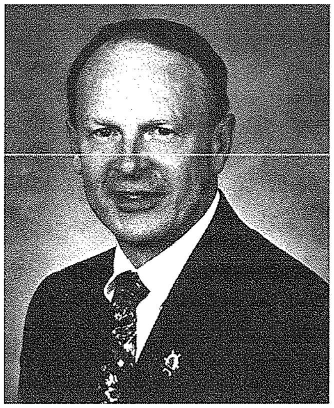
Judith M. Johnson

Judith M. Johnson
Executive Director / Chief Investment Officer

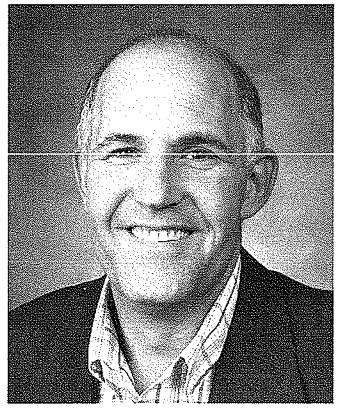
BOARD OF DIRECTORS



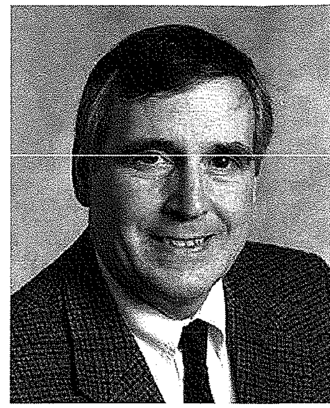
Agnes Gay
was elected to the Board in 1999 as a member representative. She was elected President in January 2004. Gay retired in 1998 after serving 16 years as Personnel Specialist and Manager of the Minneapolis Park and Recreation Board. Gay was active with the MMRA Board, serving both as Secretary of the Board and on the Legislative Committee.



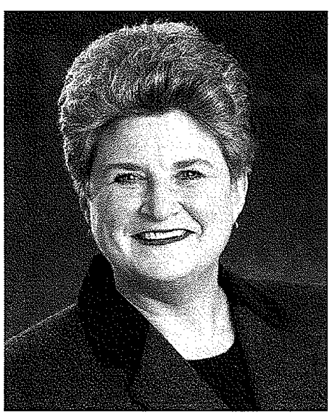
Dennis Schulstad
was elected to the Board in 1999 as a member representative. He was elected Vice President in January 2004. Schulstad formerly served on the Minneapolis City Council for 22 years. Schulstad is the only Air Force Reserve Brigadier General residing in Minnesota. Schulstad is active in civic events and other boards, including the Minnesota Alumni Association.



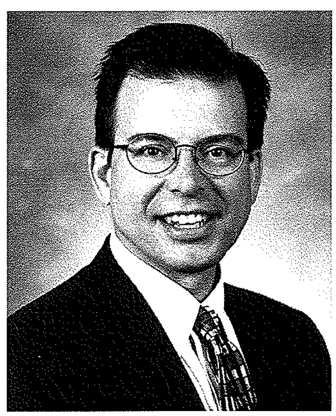
Craig Cooper
was elected to the Board in 2000 as a member representative. Cooper was a general foreman in the solid waste and recycling division of the public works department of the City of Minneapolis. He began his career in public works in 1974.



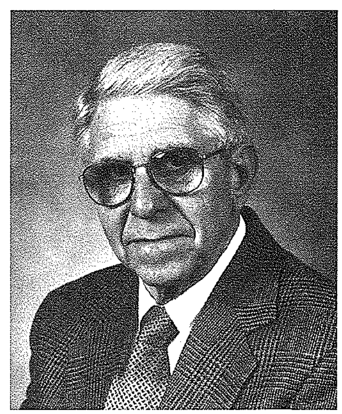
John Moir
was appointed by the Mayor to serve as his designee in February 2002. Mr. Moir is the current City Coordinator and formerly was the City Finance Director.



Barbara Johnson
was appointed to the Board by the Minneapolis City Council in January 2002. She is the Chair of the City Ways & Means Committee. She was first elected to the City Council in 1997. Prior to election to the City Council, she served 18 years representing the City of Minneapolis on the Metropolitan Parks & Open Space Commission.



Arthur (Dan) Cherryhomes
is a member representative on the MERF Board. He formerly served on the MERF Board during the 1990's



James Lind
is a member representative on the MERF Board. He was elected President from January 1991 through 2003. Prior to that he served as chairman of the Board's Finance Committee. Lind was appointed to the Board in May 1986 to fill Harlan Johnson's unexpired term. Lind retired in 1988 after working for the City of Minneapolis for 30 years, most recently as the City's Deputy City Engineer.

ADMINISTRATIVE ORGANIZATION

MERF
BOARD OF DIRECTORS

EXECUTIVE DIRECTOR/
CHIEF INVESTMENT
OFFICER

INVESTMENT ADVISORY
PANEL

BENEFIT
SERVICES

ADMINIS-
TRATION

ACCOUNTING

INVESTMENT
ANALYSIS

MERF Personnel and Professional Consultants

MERF Personnel

Judith Johnson ....Executive Director/Chief Investment Officer

Tim Caza..Benefits Manager

Cindy Hedum ....Accounting Manager

Linda Presler...Benefits Coordinator

Lu Xia ....Accountant

Professional Consultants

Ennis, Knupp & Associates..Investment Consultant

The Segal Company..State-appointed Actuary

Northern Trust Company.......................Custodian and Performance Measurement

Office of the Minnesota State Auditor ....Independent Auditor

Willeke & Daniels ....Legal Counsel

A listing of investment managers is included as part of the Schedule of Investment Fees on page 52 of the Investment Section.

INDEPENDENT AUDITOR'S REPORT

PATRICIA ANDERSON
STATE AUDITOR

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR
SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-Mail)
1-800-627-3529 (Relay Service)

INDEPENDENT AUDITOR'S REPORT

Members of the Retirement Board
Minneapolis Employees Retirement Fund

We have audited the basic financial statements of the Minneapolis Employees Retirement Fund of the City of Minneapolis, Minnesota, as of and for the year ended June 30, 2004, as listed in the table of contents. These basic financial statements are the responsibility of the Minneapolis Employees Retirement Fund's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the plan net assets of the Minneapolis Employees Retirement Fund at June 30, 2004, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis and other required supplementary information referred to in the table of contents are not required parts of the basic financial statements but are required by the Governmental Accounting Standards Board. We have applied certain limited procedures to this information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

INDEPENDENT AUDITOR'S REPORT
(CONTINUED)

The accompanying financial information listed as supporting schedules in the table of contents is presented for additional analysis and is not a required part of the basic financial statements of the Minneapolis Employees Retirement Fund. Such information has been subjected to the procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

PATRICIA ANDERSON
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: November 12, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the financial activities of the Minneapolis Employees Retirement Fund for the fiscal year ended June 30, 2004 is to assist the reader in understanding the financial statements and to provide an overall review of the financial activities during the past year. Please read the information contained in this section in conjunction with the letter of transmittal, which begins on page 4 of the Introduction section of this annual report.

Overview of the Financial Statements

MERF's basic financial statements are comprised of the *Statement of Plan Net Assets, Statement of Changes in Plan Net Assets,* and *Notes to the Financial Statements.* Also contained in the financial section is other supplementary information in addition to the basic financial statements.

The *Statement of Plan Net Assets* provides information on all of the assets and liabilities, with the difference between the assets and liabilities shown as net assets. Ultimately, increases or decreases in net assets may be used to measure whether MERF's financial condition is becoming stronger or weaker over time.

The *Statement of Changes in Plan Net Assets* describes how MERF's net assets changed during the current fiscal year. Additions and deductions represent revenues and expenses, respectively. Additions minus deductions represent the change in net assets. For the current fiscal year, MERF received revenues from contributions and investments. Expenses or deductions, consisted of benefit payments, refunds and administrative costs.

The Notes to the Financial Statements provide additional data, which is crucial in understanding the information included in the financial statements. *The Notes to the Financial Statements* are immediately following the *Statement of Plan Net Assets* and *Statement of Changes in Plan Net Assets.*

In addition to the basic financial statements, the annual report also provides required supplementary information regarding *the Schedule of Employer Contributions* and the *Schedule of Funding Progress. The Schedule of Funding Progress* provides historical trend information about the actuarially determined funded status of the plan. The *Schedule of Employer Contributions* provides historical trend information about the annual required contributions of the employers and the State of Minnesota.

Additional supporting schedules include the *Schedule of Administrative Expenses,* the *Schedule of Investment Expenses,* the *Schedule of Payments to Consultants* and the *Individual and Combining Schedules for the Active and the Retired Accounts.* The Active Account is to record the income and expenses of active employee accounts plus the Disability Retirement and Survivor Benefit Reserves. Upon retirement of an active member, the actuarially determined present value of the retirement benefits is transferred to the Retired Account. These schedules provide additional analysis of the information provided in the financial statements.

Financial Highlights

- Net Assets increased during the year from $1.19 billion in 2003 to $1.28 billion in 2004. The increase in plan assets is primarily due to investment income.
- The additions for 2004 were approximately $226 million, comprised of $49 million in contributions, and an additional $177 million earned in investment income. The additions for 2003 showed a $69 million gain that was a result of a $20 million investment gain and $49 million in contributions.
- Total deductions for the year increased from $136 million in 2003 to $138 million in 2004, or a 2.2% increase, due to cost of living adjustments and higher pension benefits because of new retirees.
- Total administrative expenses equaled $717,952. That was a decrease of 2.6% in comparison to 2003 due to a decrease in general expenses.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Plan Net Assets
(in thousands)

	2004	2003	Amount Change	Percent Change
Cash and short-term investments	$ 37,587	$ 203,007	$ (165,420)	(81.5)%
Total receivables	31,813	145,787	(113,974)	(78.2)
Investments	1,239,394	1,058,798	180,596	17.1
Invested securities lending collateral	96,248	33,189	63,059	190.0
Total assets	$ 1,405,042	$ 1,440,781	$ (35,739)	(2.5)%
Accounts payable	$ 26,077	$ 212,652	$ (186,575)	(87.7)
Securities lending collateral	96,248	33,189	63,059	190.0
Total liabilities	$ 122,325	$ 245,841	$ (123,516)	(50.2)%
Net assets held in trust	$ 1,282,717	$ 1,194,940	$ 87,777	7.3 %

Statement of Changes in Plan Net Assets
(in thousands)

	2004	2003	Amount Change	Percent Change
Employer contributions	$ 38,366	$ 38,102	$ 264	0.7 %
State of MN contribution	7,093	6,632	461	7.0
Employee contributions	3,343	4,167	(824)	(19.8)
Net investment income	177,511	19,654	157,857	803.2
Total additions	$ 226,313	$ 68,555	$ 157,758	230.1 %
Benefits	$ 137,238	$ 134,409	$ 2,829	2.1%
Refund of contributions	580	357	223	62.5
Administrative expenses	718	737	(19)	2.6
Total deductions	$ 138,536	$ 135,503	$ 3,033	2.2 %
Increase (Decrease) in Net Assets	$ 87,777	$ (66,948)	$ 154,725	231.1 %

Financial Analysis

MERF's total assets for 2004 were $1.40 billion and were comprised of investments recorded at fair value plus receivables and invested securities lending collateral. Total assets decreased by $36 million or 2.5% from the prior year.

Total liabilities for 2004 were $122 million and were mainly accounts payable, predominately for securities purchased, deferred premiums on options contracts at fair value plus obligations related to securities lending. Total liabilities decreased $124 million or 50.2% from the prior year primarily due to a decrease in accounts payable for securities purchased.

MERF's assets exceeded its liabilities at the close of 2004 by $1.28 billion. Total net assets held in trust increased by $88 million or 7.3% from the previous year. There were deductions of $139 million that were a result of benefit payments, refunds of contributions and administrative expenses. There were additions of $226 million that came from $49 million in contributions and $177 million in investment income.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Additions to Plan Net Assets

The reserves needed to finance retirement benefits are accumulated through the collection of employer, employee, State of MN contributions and through earnings on investments. Employee contributions totaled $3 million and declined from the prior year by 19.8%. The MERF fund is closed to new members so the pool of active member's contributions to MERF declines each year as active members retire.

Employer contributions totaled $38 million, which representes an increase of 0.7% from the prior year. Employer contributions normally decline from one year to the next. Last year however, the City of Minneapolis made an extra contribution of $29 million to fund the cost of new retirements. This year employers made extra contributions of $31 million to fund the cost of new retirements. The City of Minneapolis contributed $25 million, the Minneapolis-St.Paul Metropolitan Airports Commission contributed $4 million and the Minneapolis Special School District No.1 has a receivable for $2 million.

The state contribution was $7 million, which is an increase of $461,000 from the previous year. The required state contribution presented in the financial statements is based on the actuarial results for the period ending June 30, 2003. MERF expects the state contribution to rise for future periods when investment performance produces actuarial losses instead of actuarial gains. The largest impact from weak investment performance is on the state contribution and not employer contributions due to the requirements of apportionment contained in state law.

Investment income for 2004 totaled $177 million while there was a net gain of $20 million from investing activities in 2003.

The net impact of contributions and investment income for the year was of $226 million or an increase of $158 million, or 230.1% from the prior year. The investment section of this report reviews the results of investment activity for fiscal year 2004.

Deductions from Plan Net Assets

The primary deductions include the payment of pension benefits to members and beneficiaries, refunds of contributions to former members and the cost of administering MERF. Total deductions for 2004 were $139 million and an increase of 2.2% over 2003 expenditures.

The payment of pension benefits increased the deductions by $3 million or 2.1% from the previous year. In addition to the automatic cost of living increase that is provided to the members, there is also the total increase in monthly payments that relates to new retirees being added to the retirement payrolls during the year that is greater than the total of the monthly payments to retirees and their beneficiaries who died during the year.

Administrative expenses decreased by $19,000 or 2.6% from the previous year.

Retirement System Overview

MERF's net assets have increased over the past two years due to an improvement in the domestic and foreign equity markets. This year's gain came about because of a general improvement in the economy which in turn resulted in strong corporate earnings. MERF's domestic, international and real estate portfolio all produced very positive returns this year. The bond portfolio managed to produce a small gain even though there were rising inflationary pressures and interest rate increases.

MERF employs an actuary who produces a valuation on an annual basis. This valuation shows that MERF is on track to meet its financial commitments and to achieve full funding of all liabilities by 2020. In addition, MERF enjoys special funding protection contained in state statute that requires the local employers to provide additional funding in the year following the year that the employer's account goes negative. This year three employers had their accounts go negative; they were the City of Minneapolis, the Minneapolis-St.Paul Metropolitan Airports Commission, and the Minneapolis Special School District No.1 (SSD1). A receivable was set up for SSD1 and the other two employers paid in full.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Unlike many public funds that require employer funding at a percentage of payroll, MERF's enabling law requires the actuary to calculate the actual funding needs of MERF on an annual basis and then prorates the exact amount necessary to fund MERF on an annual basis into the required contributions from the State of Minnesota and the employer groups. Thus, MERF is assured that it will never have a funding deficiency and that it is guaranteed to be fully funded by 2020. This effectively means that if investment markets do not improve quickly the MERF fund will still achieve full funding by 2020, although, with higher state and local employer contributions to fund the unfunded liabilities of MERF.

Contacting MERF's Financial Management

This financial report is designed to provide the Retirement Board, the membership, the contributing employers and the other general users with a general overview of MERF's finances. If you have questions about this report or desire more detailed information, please contact us at Minneapolis Employees Retirement Fund, 800 Baker Building, 706 2nd Avenue South, Minneapolis, MN 55402.

Basic Financial Statements

Statement of Plan Net Assets — As of June 30, 2004

ASSETS	
Cash and Short-term Investments	$ 37,587,047
Receivables	
Accounts receivable, primarily for securities sold	10,481,064
Variation margins receivable	29,988
Contributions receivable	17,354,151
Accrued interest	3,399,648
Dividends receivable	548,224
Total Receivables	31,813,075
Investments, at fair value	
Bonds	491,394,002
Stock	685,466,375
Stock - real estate investment trusts	62,012,173
Mortgages	521,304
Total Investments	1,239,393,854
Invested Securities Lending Collateral	96,247,918
Total Assets	1,405,041,894
LIABILITIES	
Accounts Payable, primarily for securities purchased	25,624,751
Other Liabilities	22,091
Deferred Premiums on Option Contracts, at fair value	408,758
Forward Currency Contracts	21,023
Obligations from Securities Lending Collateral	96,247,918
Total Liabilities	122,324,541
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 1,282,717,353

(A Schedule of Funding Progress
is presented on Page 29)

The accompanying notes are an integral part of this financial statement.

Basic Financial Statements

Statement of Changes in Plan Net Assets — Fiscal Year Ended June 30, 2004

ADDITIONS	
Contributions	
Employer	$ 38,366,011
State	7,093,000
Employee	3,342,960
Total Contributions	48,801,971
Investment Income	
From investing activities	
Net appreciation (depreciation) in fair value of investments	161,290,208
Interest	14,204,694
Dividends	5,763,089
Other investment income (loss)	359
	181,258,350
Less investment expense	(3,885,872)
Net income from investing activities	177,372,478
From securities lending activities	
Securities lending income	1,209,377
Securities lending expense:	
Borrower rebates	(1,016,703)
Management fees	(54,437)
Commissions	(21)
Total securities lending expenses	(1,071,161)
Net income from securities lending activities	138,216
Total net investment income	177,510,694
Total Additions	226,312,665
DEDUCTIONS	
Benefits	137,238,098
Refunds of Contributions	579,783
Administrative Expenses	717,952
Total Deductions	138,535,833
NET INCREASE	87,776,832
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	
Beginning of Year	1,194,940,521
End of Year	$ 1,282,717,353

The accompanying notes are an integral part of this financial statement.

NOTES TO THE FINANCIAL STATEMENTS

1. PLAN DESCRIPTION

A. Purpose

The Minneapolis Employees Retirement Fund (MERF) was established in 1919 by the Minnesota State Legislature to provide members with survivor and disability protection during employment and financial security after retirement.

B. Administration and Financial Reporting Entity

MERF is a cost-sharing multiple employer defined benefit retirement plan, with the administrative costs being allocated each year to participating employers based on active membership. MERF is governed by a seven-member Board of Directors (the Board). Five member representatives, two of whom must be retired members, are elected to the Board by the membership of the Minneapolis Municipal Retirement Association. Under State law, two elected officials serve ex-officio as Board members. These members are the Mayor of the City of Minneapolis, or his or her designee, and a representative of the Minneapolis City Council. The Board has final authority over, and responsibility for, the administration of MERF.

The management of the Fund is vested in the Executive Director, who is retained by the Board to carry out the policies of the Board. The Executive Director has the responsibility for administering the Fund in accordance with Minnesota Statute (Minn. Stat.) Chapter 422A. MERF is not subject to the provisions of the Employee Retirement Income Security Act of 1974.

C. Participation

- Employer Membership

  Employers participating in MERF include:

  The City of Minneapolis
  Minneapolis Special School District No. 1
  Minneapolis-St. Paul Metropolitan Airports Commission
  Metropolitan Council/ Environmental Services
  Minnesota State Colleges and Universities
  Hennepin County

- Employee Membership

  Employee membership in MERF was restricted by law to those employees, employed by the participating employers, hired prior to July 1, 1978. Employees hired after June 30, 1978, are required to become members of the Minnesota Public Employees Retirement Association.

MERF members consist of:

Retirees and beneficiaries receiving benefits	4,981
Terminated employees entitled to benefits but not yet receiving them	181
Current active employees fully vested	552
Total Participants	5,714

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

MERF's financial statements are prepared using the accrual basis of accounting. Employee and employer contributions are recognized as revenues when due, pursuant to formal commitments, as well as statutory or contractual requirements. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

This financial report was prepared in conformity with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis - for State and Local Governments*, as amended.

B. Basis of Presentation

MERF's financial statements are presented using fund accounting and there are three funds, the Deposit Accumulation Fund (DAF) Active Account, the Survivor and Disability Fund (SDF) Active Account and the Retired Account.

- Deposit Accumulation Fund Active Account

  The DAF Active Account is maintained for the purpose of recording contributions, investment income and expenses to active employee accounts and various employer accounts. Upon retirement of an active member, the actuarially determined present value of benefits to be paid to the retiree is transferred to the Retired Account for the purpose of providing benefits to the retiree. When a disability becomes effective, an amount equal to the actuarially determined present value of the disability is transferred to the SDF Active Account.

- Survivor and Disability Fund Active Account

  The SDF Active Account consists of contributions for survivor benefits made by employees and employers, and an actuarially determined disability reserve. Each reserve earns a proportional share of investment income and expenses. Survivor and disability benefits are paid from this fund.

- Retired Account

  The Retired Account is maintained for the purpose of recording contributions, investment income and expenses for retired members. Its resources are invested to provide monthly benefits to retirees, including annual retirement benefit increases.

C. Method Used to Value Investments

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. The fair value of mortgages, contracts for deeds and certain real estate is based on independent appraisals and valuations. Investments that do not have an established market are reported at estimated fair value.

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

MERF maintains its accounting records in U.S. dollars. Investment securities and other assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the prevailing rates of exchange at the end of the period. Purchases and sales of securities, income and expenses are translated into U.S. dollars at the prevailing exchange rate on the respective dates of the transactions.

Security transactions are accounted for on the date the securities are purchased or sold. For purposes of determining realized gains and losses on sales of investments, the cost of investments is determined on the specific identification method. The increase (or decrease) in fair value is combined with the realized gains and losses on sales of investments. This combined amount is reflected as net appreciation (or depreciation) in fair value of investments in the accompanying financial statements.

The Board maintains a written investment policy with specified investment objectives and established benchmarks against which investment performance is to be measured. Performance against these objectives and benchmarks for each type of investment is periodically evaluated.

D. Accounting for Derivatives

MERF invests in various derivative instruments, including futures contracts, options and interest rate swaps, with the investment objective of exceeding the total return of the S&P 500 index by using arbitrage strategies. In addition, MERF invests in forward currency exchange contracts.

- Futures Contracts

Upon entering into a futures contract, each party is required to deposit with the broker an amount, referred to as an initial margin, equal to a percentage of the purchase price indicated by the futures contract. In lieu of a cash initial margin, the broker is holding certain investments held by MERF as collateral. Subsequent deposits, referred to as variation margins, are received or paid each day by each party equal to the daily fluctuations in the fair value of the contract. These amounts are recorded by each party as unrealized gains or losses. When a contract is closed, each party records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

Futures contracts involve, to varying degrees, credit and market risks. MERF enters into contracts only on exchanges or boards of trade where the exchange or board of trade acts as the counterparty to the transaction. Thus, credit risk on such transactions is limited to the failure of the exchange or board of trade. Losses in value may arise from changes in the value of the underlying instruments or if there is an illiquid secondary market for the contracts.

- Options

MERF's investment in options gives it the right, but not obligation, to buy (call) or sell (put) such options at a fixed price (exercise or strike price) during a specified period. MERF pays a nonrefundable fee (the premium) to the seller (the writer). Option contracts are valued daily. Unrealized gains or losses are recorded based upon the last sales price on the principal exchange on which the option is traded. A realized gain or loss is recognized upon expiration or closing of the contract. When an option is exercised, the proceeds on sales for a written call option, the purchase cost of the security for a written put option, or the cost of the security for a purchased put or call option is adjusted by the amount of premium received or paid.

The risk in buying an option is that a premium is paid whether or not the option is exercised. The risk in writing a call option is the lost opportunity for profit if the market price of the security increases and the option is exercised. The risk in writing a put option is that a loss may be incurred if the market price of the security decreases and the option is exercised. Risks may also arise from an illiquid secondary market, or from the inability of counterparties to meet the terms of the contract.

- Interest Rate Swaps

An interest rate swap contract is entered into between two parties who both agree to exchange interest payments on a specified principal amount for a specified time period. Since the principal never changes hands, it is referred to as notional. A swap does not involve the purchase or sale of an asset. Accordingly, there are no realized gains or losses on swaps, even upon expiration of the contract. Unrealized gains and losses are reported based on current fair values on preestablished dates. Cash settlements of income or expense, which are made on preestablished dates, are reported as part of interest income.

Credit risk exists due to the risk of default by the counterparty. There is no risk to MERF if it is in a loss position, but there is risk if MERF is in a gain position, relying upon payment from the counterparty. MERF enters into swaps based upon the credit rating of the broker and counterparty. Collateral is not received.

- Forward Currency Exchange Contracts

A forward currency exchange contract is an agreement between two parties to pay or receive specific amounts of a currency at a future date in exchange for another currency at an agreed upon exchange rate. Forward currency exchange contracts are valued at an estimate of the exchange rate on the settlement date. These amounts fluctuate daily, and the fluctuation is captured in the market value as unrealized gain/loss. On the settlement date, the difference between the contract exchange rate and the actual exchange rate on that day is recorded as realized gain/loss. Risks may arise from an illiquid secondary market or from the inability of counterparties to meet the terms of the contract.

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

E. Direct Investment Expenses

Direct investment expenses are charged against investment income. Investment expenses include all expenses incurred for the retention of professional external investment managers and investment consultants, custodian bank fees and costs incurred to manage investment portfolios or assets internally.

F. New Active Fund

In previous years, MERF had one Active Fund with three reserve accounts. This year, the Deposit Accumulation Reserve became a separate fund called the DAF Active Account, and the Survivor Benefit and the Disability Retirement Reserve became the SDF Active Account. MERF now has two active funds.

3. RETIREMENT BENEFITS

A. Eligibility

MERF has been a closed fund since July 1, 1978. As such, all participants are fully vested. However, for financial reporting, the cost associated with future disability or death benefits is considered to be non-vested. Under Minn. Stat. Sections 422A.13, 356.32 and 422A.15, participants are eligible for retirement either:

- With 30 or more years of service at any age; or
- At age 60 with three or more years of service; or
- At age 65 with one year of service; or
- With 20 or more years of service at age 55 under the Two Dollar Bill method of retirement (money purchase plan), if a MERF member prior to June 28, 1973.

B. Types of Annuities

- Normal Service Retirement

  This is a term used when an employee retires meeting the above eligibility requirements.

- Deferred Annuity

  Members who leave public service may leave their contributions with MERF to start receiving retirement benefits at the age of 60. Prior to reaching age 60, these employees may choose to withdraw their contributions with interest. If an employee dies while on deferred annuity, the beneficiary will receive a full refund of the contributions, with interest, and an accumulated employer benefit. Upon reaching an eligible retirement age, employees must apply for a service retirement and choose the option under which to calculate their monthly benefit.

C. Retirement Options

Minn. Stat. Section 422A.17 provides a number of retirement options from which the participant may choose. The maximum benefit one may receive is a retirement allowance payable throughout life. Participants may receive lesser retirement allowances if they choose payments for a guaranteed number of years, request a certain percent or dollar amount of their retirement allowances to go to a beneficiary or if they choose to provide for a certain amount to be paid out upon death. Retirement options include:

- Single Life

  This is a monthly lifetime benefit payable to the retiree. Upon the date of death, all benefits cease under this option.

- Option 1

  This pays the retiree a lower monthly benefit, but upon the death of the retiree, the remaining value of the pension benefit, if any, is paid to the beneficiary in a lump sum.

- Option 2

  This option pays the retiree a reduced monthly benefit for life, and upon death continues to pay a like amount for the life of the designated beneficiary.

- Option 3

  This is similar to Option 2, except that upon the death of the retiree the benefit payable to the beneficiary is reduced by 50% and is payable for the life of the beneficiary.

- Option 2 or 3 With a Bounce Back Provision

  Option 2 or 3 may choose a "bounce-back" provision. This option would further reduce the monthly benefit amount, but if the designated survivor should die first, the monthly annuity amount would increase or "bounce back" to what the amount would have been had a single life annuity been chosen at retirement rather than a joint and survivor annuity.

- Option 4—10 Year Certain

  This option pays the retiree a monthly benefit for life. If the retiree dies within the first ten years, the benefit is paid to the beneficiary for the balance of the ten-year period.

- Option 4—Death Benefit

  Under this option, the employee is selecting a Single Life Option less the amount of premium each month required to pay the death benefit amount chosen by the employee. The death benefit amount may not be less than $500 or more than 1/2 the value of the employee's total retirement benefit.

- Option 4—Other Plan Selected

  The employee may select any other plan, subject to the approval of the Board and provided it is of equal actuarial value to the Single Life Option.

- Two Dollar Bill Method of Retirement

  This method of retirement is only available to employees who were members of MERF prior to June 28, 1973. This is what insurance companies commonly refer to as a money purchase plan.

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

- Combined Annuities

  A monthly retirement benefit is available to employees who have under three years of service in MERF, but only when these years, combined with service in other Minnesota statewide retirement systems, total three or more years. A monthly retirement benefit is also available to employees who have less than three years of combined allowable service in any of the qualifying funds, provided the employee works until age 65.

D. Formula for Benefits

The benefit amount for all options, other than the Two Dollar Bill Option, is determined from the calculated amount for the Single Life Option. This calculation is based on the average of the highest five years salary within the last ten years of employment, and years of creditable service at the date of retirement. The employee will receive a benefit amount of 2% of that average salary for each of the first ten years of service and 2.5% of that salary for each year over ten years of service.

The formulas used in calculating pension benefit increases are contained in Minnesota State Law. Increases may only be paid from investment earnings which exceed the actuarial assumption of a 5% return set for Minnesota statewide retirement systems. Benefit increases are calculated by the state-appointed actuary, who also determines the reserves required to maintain MERF as an actuarially and financially sound pension fund. Increases in pension benefits are permanent and guaranteed because they are fully funded; that is, the amount necessary to sustain the increase has been set aside.

4. SURVIVOR DEATH BENEFITS

A. Death of Member with Less Than 20 Years of Service

The beneficiary is entitled to a full refund of the member's retirement contributions. In addition, the surviving spouse will receive 30% of the member's average salary over the last six full months of service preceding death. Each surviving child receives 10%. The initial maximum family benefit cannot exceed $900 per month.

B. Death of Member with Over 20 Years of Service

The beneficiary is entitled to a full refund of the member's retirement contributions. In addition, the beneficiary is entitled to receive a survivor benefit life income. The monthly benefit is the actuarial equivalent of what the member would have received if the member had retired on the date of death. Only the member's spouse, or if none, a dependent child or a dependent parent, can be designated as a beneficiary of the survivor benefit life income.

If a member does not designate a beneficiary, then a surviving spouse, or if none, a dependent child or dependent parent, may, within 60 days of the member's death, file an application with MERF for a reduced survivor benefit life income.

5. DISABILITY BENEFITS

Disability, whether duty or non-duty, means that an employee is unable to perform the duties required in the ordinary course of employment.

A. Requirements

- The disabled employee must submit an application for disability retirement to MERF. This application must be approved by the Medical Board, which determines disability by considering both the physical and mental health of the disabled employee. The Medical Board is comprised of the Minneapolis City Physician, a physician retained by MERF and the employee's own physician.

- The employee must be under age 60 and have five years of service if the disability is not employment-related. There is no service requirement for employment-related disability.

- Under age 60, a disabled employee may be required to have an annual medical examination. If the employee is able to return to his or her former employment, the disability retirement ends.

B. Formula

In calculating the disability retirement benefit, the employee's years of service equals the greater of:

- the number of actual years of service completed plus the number of years the employee would have worked up to age 60, with a combined maximum of 22 years; or

- the actual number of years of service if greater than 22 years.

The disability retirement benefit is, by State law, subject to an income restriction. If a disabled employee's outside income from workers' compensation or other sources combined with the disability benefit exceeds his or her earnings at the time of disability, the disability benefit is reduced to that extent. At age 60, the disability retirement is automatically converted into a regular service retirement, which continues for life without the income restriction.

C. Returning to Work

Employees qualify for disability retirement only so long as the Medical Board continues to certify the employee as disabled. If, within five years of the date of the disability, the Medical Board certifies that the employee is able to return to work, the employer must reemploy the employee at a salary not less than the disability retirement benefit. After five years, reemployment is at the option of the employer. After age 60, the employee can not be reemployed.

6. CASH SETTLEMENTS

If a contributing member dies with under ten years of service and does not have a surviving spouse or child who qualifies for

NOTES TO THE FINANCIAL STATEMENTS

(CONTINUED)

survivor benefits, the member's beneficiary receives, in a lump sum, a refund of all personal contributions along with a $750 death benefit. The beneficiaries of a deceased member with over ten years of service receive, in a lump sum, a refund of the member's personal contributions, a $1,500 death benefit and an accumulated employer benefit.

7. SEPARATION REFUNDS

Employees leaving public service any time before retirement and before age 60 may receive a refund of all personal contributions, with interest, except for the survivor benefit contribution, which is the equivalent of a non-refundable term insurance premium.

Employees who leave public service after age 60 may not withdraw personal contributions with interest unless they have worked under three years and do not qualify for monthly retirement benefits. The survivor benefit contribution is non-refundable.

8. CONTRIBUTIONS

A. Employer Contributions

Employer contribution rates are determined and calculated pursuant to provisions set forth in Minn. Stat. Section 422A.101.

Employers contribute the normal cost, as determined in the annual actuarial valuation, plus amounts to cover administrative costs. To fully amortize the unfunded actuarial accrued liability by June 30, 2020, as required by Statute, employers also contribute an additional 2.68% of covered payroll plus an amount totaling $3.9 million annually.

Commencing in 1986, the Minneapolis-St.Paul Metropolitan Airports Commission and the Metropolitan Council/ Environmental Services were required to contribute towards the amortization of the unfunded liability, in addition to the above contributions. These contributions were previously made by the State of Minnesota.

Commencing in 2000, employers are also billed for the cost of providing an annual cost of living adjustment, plus a sum which amortizes the cost of providing an increase in base benefit for survivors of MERF active members who died with less than twenty years of service.

Pursuant to Minn. Stat. Section 422A.101, subd.3, if the required annual amortization amount, as provided by the above employer contributions and the maximum state contribution described below, exceeds $11,910,000, the excess must be allocated back to the employers, exclusive of the Minneapolis-St. Paul Metropolitan Airports Commission and the Metropolitan Council/Environmental Services.

B. State Contributions

Minn. Stat. Section 422A.101 provides for an annual contribution to be made by the State of Minnesota for the purpose of amortizing the unfunded actuarial accrued liability. The contribution amount is calculated pursuant to Minnesota Statute and is based on a target date of June 30, 2020 for full amortization. The maximum annual State contribution is $9,000,000.

C. Employee Contributions

Employee contributions for retirement benefits are established by Minn. Stat. Section 422A.10 as a percentage of total compensation and are deducted from the employee's salary and remitted by the participating employers. The current contribution rate is 9.25%.

Employees also contribute a percentage of total compensation for survivor benefits, pursuant to Minn. Stat. Section 422A.23, which is accounted for in the Survivor Benefits Reserve. This rate is currently 0.5%.

A participant who terminates covered employment may claim a refund of employee contributions plus interest, as defined by Minnesota Statutes. Service credits may be repurchased upon return to covered employment under certain circumstances, as defined by Minnesota Statutes.

9. RESERVE ACCOUNTS

A. Net Assets Held in Trust for Pension Benefits

Net Assets Held in Trust for Pension Benefits as of June 30, 2004 are as follows:

DAF Active Account:	
Deposit Accumulation Reserve	$ 74,285,963
SDF Active Account:	
Survivor Benefits Reserve	43,774,136
Disability Retirements Reserve	67,162,387
Retired Account:	
Retirement Benefits Reserve	1,097,494,867
Net Assets Held in Trust for Pension Benefits	$ 1,282,717,353

B. Deposit Accumulation Fund Active Account - Description (DAF Active)

- Deposit Accumulation Reserve

  The Deposit Accumulation Reserve consists of employer, employee and state contributions, as well as income from investments. Payments made from the Deposit Accumulation Reserve are primarily for amounts required to be transferred to the Retired Account or the Disability Retirements Reserve, refunds of contributions and administrative expenses. The Deposit Accumulation Reserve will be fully funded by June 30, 2020, as is required by statute.

C. Survivor and Disability Fund Active Account - Description (SDF Active)

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

- Survivor Benefits Reserve

  The Survivor Benefits Reserve consists of contributions for survivor benefits made by employees and employers. A proportionate share of income from investments is allocated to this reserve. Survivor benefits are paid as specified in Minn. Stat. Section 422A.23. The Survivor Benefits Reserve is fully funded.

- Disability Retirements Reserve

  Pursuant to Minn. Stat. Section 422A.18, when a disability allowance becomes effective, an amount equal to the present value of the disability allowance is transferred from the Deposit Accumulation Reserve to the Disability Retirements Reserve. In addition, a proportionate share of income from investments is allocated to the Disability Retirements Reserve.

  Upon termination of a disability allowance, for any reason other than death of the recipient, the present value of the allowance as of the date of termination is transferred from the Disability Retirements Reserve back to the Deposit Accumulation Reserve.

  At the end of each year, the Disability Retirements Reserve is actuarially valued. Any excess of assets over actuarial reserve requirements is transferred to the Deposit Accumulation Reserve. Any actuarial requirements in excess of assets are funded by a transfer from the Deposit Accumulation Reserve. As of June 30, 2004, the Disability Retirements Reserve had $3,378,609 of assets in sufficiency of actuarially required reserves. A transfer of these assets to the Disability Retirements Reserve from the Deposit Accumulation Reserve has been made in accordance with Minn. Stat. 422A.06, Sub. 7(c). The Disability Retirements Reserve is fully funded.

D. Retired Account - Description

- Retirement Benefits Reserve

  The Retirement Benefits Reserve represents the actuarially determined required reserves for retired members. Upon retirement of an active member, the actuarially determined present value of benefits to be paid to the retiree is transferred from the Active Account to the Retired Account for the purpose of providing benefits to the retiree.

  At the end of each year, the Retirement Benefits Fund (RBF) Reserve is actuarially valued and a transfer of reserves is calculated. The purpose of this transfer is to ensure that the total RBF reserve is fully funded to the liability of the RBF retirees. The transfer of reserves is the difference between the actuarial reserves and the expected reserves, determined as the adjustments of annuities and benefits for the RBF fund. If the actuarial reserves are greater than the expected reserves, a transfer of the difference between the actuarial and expected is required from the Active Account to the Retired Account. If the expected reserves are greater than the actuarial reserves, a transfer of the difference between the expected and actuarial is required from the Retired Account to the Active Account. As of June 30, 2004, the actuarial reserves were greater than the expected reserves in the RBF fund, which resulted in a difference of $8,783,588. In accordance with Minn. Stat. 11A.18, Subd. 11, a transfer of assets from the Active Account to the Retired Account will be made prior to December 31, 2004. The Retirement Benefits Reserve is fully funded.

10. CAPITAL ASSETS

MERF follows the policy of expensing capital assets (office and computer equipment, furniture and software) at the time of purchase. As of June 30, 2004, MERF owned capital assets with a cost of $271,949. Capital assets are not being capitalized or depreciated, due to immateriality.

11. DEPOSITS AND INVESTMENTS

A. Deposits

In accordance with Minnesota Statutes, the Board authorizes the maintenance of deposits at depository banks, all of which are members of the Federal Reserve system.

MERF's deposits have been categorized to give an indication of the level of custodial credit risk assumed. This risk categorization does not reflect market risk.

- Category 1 includes deposits that are insured or collateralized with securities held by MERF or by its agent in MERF's name.
- Category 2 includes deposits which are collateralized with securities held by the pledging financial institutions trust department or agent in MERF's name.
- Category 3 includes deposits which are uncollateralized.

On June 30, 2004, the carrying amount of MERF's deposits was $23,256 and the bank balance was $118,876. The bank balance is categorized as follows:

Category 1	$ 118,876
Category 2	0
Category 3	0
	$ 118,876

B. Investments

Investments are governed by Minn. Stat. Sections 422A.05 and 356A.06. These statutes specify the types of investments in which MERF may invest, including, but not limited to, the following:

- Short-term Cash Equivalents
- Government Obligations

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

- Corporate Obligations
- Limited Partnerships
- Mutual Funds
- Stock
- Real Estate
- Derivatives
- Securities Lending

Investments at fair value as of June 30, 2004, were as follows:

Bonds	$ 491,394,002
Stock	685,466,375
Stock - Real Est. Inv. Trusts	62,012,173
Mortgages	521,304
Inv. Sec. Lending Collateral	96,247,918
Sub-total	1,335,641,772
Short-term Investments	37,563,791
Total Investments	$ 1,373,205,563

MERF's investments are categorized in the table on page 26 to give an indication of the level of custodial credit risk assumed by MERF as of June 30, 2004. Investments not readily classifiable into one of the three risk categories have been itemized and presented only with fair value amounts.

- Category 1 includes investments that are insured or registered or for which the securities are held by MERF or its agent in MERF's name.
- Category 2 includes uninsured investments for which the securities are held by the counterparty's trust department or agent in MERF's name.
- Category 3 includes uninsured and unregistered investments for which the securities are held by the counter-party or by its trust department or agent but not in MERF's name.

MERF participates in several pooled investments representing investments in debt, equity and real estate securities. Money is transferred into the investment pools and MERF receives an appropriate ownership percentage of the pooled portfolios based on fair values. All activities of the investment pools are allocated to MERF based upon MERF's respective ownership percentage. The fair values of the pooled investments, $119,392,345, $632,994,866 and $61,114,333 are included in bonds, stock, and stock-real estate investment trusts, respectively, in the Statement of Plan Net Assets.

MERF has authorized two of its investment managers to invest MERF funds in various derivative instruments by entering into short term contracts on stock index futures, call and put options and interest rate swaps. The investment objective of one of the two managers is to exceed the total return of the S&P 500 index by using various options to purchase the equivalent of the S&P 500 index in the least costly manner while investing the underlying cash to exceed the return of LIBOR. The investment objective of the other manager is to exceed the total return of the Lehman Brothers Aggregate Return. These managers may selectively employ put and call strategies to achieve this objective. According to the investment management contracts, total risk exposure can never exceed 100% of the net fair value of the underlying securities in the accounts. As of June 30, 2004, the net fair value of assets in the accounts under management was $212,030,724 and there were 147 derivative contracts outstanding with a total exposure of $28,183,254.

Derivatives reported in the Statement of Plan Net Assets as of June 30, 2004 include $408,758 in deferred premiums on option contracts.

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

AS OF JUNE 30, 2004

Investment Type	Credit Risk Category 1	2	3	Fair Value (Carrying Amount)
DAF ACTIVE ACCOUNT				
Investments - Not Categorized				
Pooled Fixed Income Index Funds				$ 62,935,076
Pooled Government Securities Cash Fund				1,979,605
Total DAF Active Account	$ 0	$ 0	$ 0	$ 64,914,681
SDF ACTIVE ACCOUNT				
Investments - Categorized				
Commercial Paper	$ 18,289			$ 18,289
Cash Collateral on Foreign Exchange	18,320			18,320
Short Term Notes	27,414			27,414
U.S. Treasury Bills	63,057			63,057
U.S. Treasury Notes	2,323,703			2,323,703
Bonds	9,828,888			9,828,888
Stock	4,528,003			4,528,003
Investments - Not Categorized				
Pooled Stock Index Funds				57,982,330
Pooled Stock - Real Estate Investment Trusts				5,598,073
Pooled Fixed Income Index Funds				10,936,339
Pooled Government Securities Cash Fund				4,993,457
Stocks held by brokers/dealers under securities loans				360,630
Bonds held by brokers/dealers under securities loans				16,157,907
Invested Securities Lending Collateral				8,816,309
Total SDF Active Account	$ 16,807,674	$ 0	$ 0	$ 121,652,719
RETIRED ACCOUNT				
Investments - Categorized				
Commercial Paper	$ 181,370			$ 181,370
Cash Collateral on Foreign Exchange	181,680			181,680
Short Term Notes	271,867			271,867
U.S. Treasury Bills	625,341			625,341
U.S. Treasury Notes	23,044,237			23,044,237
Bonds	97,473,385			97,473,385
Stock	44,904,344			44,904,344
Investments - Not Categorized				
Mortgages				521,304
Pooled Stock Index Funds				575,012,536
Pooled Stock - Real Estate Investment Trusts				55,516,260
Pooled Fixed Income Index Funds				108,456,006
Pooled Government Securities Cash Fund				29,203,390
Stocks held by brokers/dealers under securities loans				3,576,373
Bonds held by brokers/dealers under securities loans				160,238,461
Invested Securities Lending Collateral				87,431,609
Total Retired Account	$ 166,682,224	$ 0	$ 0	$ 1,186,638,163
TOTAL INVESTMENTS	$ 183,489,898	$ 0	$ 0	$ 1,373,205,563

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

12. SECURITIES LENDING

Minn. Stat. Section 356A.06, Subd. 7 permits MERF to enter into securities lending transactions, which are loans of securities to brokers/dealers and other entities (the "borrowers") for collateral with a simultaneous agreement to return the collateral for the same securities in the future. MERF's securities custodian is the lending agent and administers the program. On June 30, 2004, 37.94% of MERF's individual security holdings were loaned out. The borrowers provide cash, U.S. Government Obligations or irrevocable letters of credit as collateral against loans. U.S. securities are loaned versus collateral valued at least equal to 102% of market value of the securities plus accrued interest. Non-U.S. securities are loaned versus collateral valued at least 105% of the market value of the securities plus any accrued interest. MERF does not have the ability to pledge or sell the collateral unless the borrower defaults.

MERF has no credit risk exposure to borrowers because the amount MERF owes the borrowers exceeds the amount the borrowers owe MERF. The lending agent provides indemnification to lenders for replacement of any loaned securities (or, in certain circumstances, return of equivalent cash value) due to borrower default on securities loans. As of June 30, 2004, the fair value of securities loaned and collateral received were $180,333,371 and $184,275,035 respectively. Cash collateral received in the amount of $98,249,964 is included in the Statement of Plan Net Assets as an asset and as an offsetting liability. The securities on loan at year-end are presented as unclassified in the schedule of custodial credit risk.

All securities loans can be terminated on demand by either the lending agent or the borrower. Cash collateral is invested in a short-term investment pool which had an average weighted maturity of 24 days. There are no restrictions on the amount of securities that can be lent at one time or to one borrower. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses known to the securities lending agent. There are no dividends or coupon payments owing on the securities lent.

13. NON-READILY MARKETABLE INVESTMENTS

The financial statements include various investments whose values have been estimated, due to the absence of readily ascertainable market values. The investments described below encompass the majority of the total value of these investments.

As of June 30, 2004, MERF had approximately $ 522,000 invested in mortgages. The fair value is equal to the remaining principal balance, which is covered by a principal agreement.

14. INCOME TAXES

MERF is exempt from payment of any federal or state income taxes, since it is a government-sponsored retirement plan, as defined by Section 414(d) of the Internal Revenue Code.

15. OPERATING LEASE

MERF is obligated under a lease agreement for office space in Minneapolis, Minnesota, at an annual base rent of $27,160 for the initial lease term, and $16,296 for the second lease term, plus its pro rata share of occupancy costs assessed by the building's management. The initial lease term is for five years, expiring November 30, 2004, and the second lease term is for five years, expiring November 30, 2009. Future minimum lease payments are as follows:

Fiscal Year Ended June 30	
2005	$ 20,823
2006	16,296
2007	16,296
2008	16,296
2009	16,296
2010	6,790
	$ 92,797

16. RISK MANAGEMENT

MERF is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. MERF manages its risk of loss through the purchase of commercial insurance. There were no significant reductions in insurance coverage from the previous year, nor have there been settlements in excess of insurance coverage for any of the past three fiscal years.

17. DEFINED BENEFIT PENSION PLAN - COVERING MERF EMPLOYEES

A. Plan Description

All full-time and certain part-time employees of MERF are covered by a defined benefit plan administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the Public Employees Retirement Fund (PERF), the Public Employees Police and Fire Fund (PEPFF), and the Local Government Correctional Service Retirement Fund (LGCSRF), which are cost-sharing, multiple-employer retirement plans. These plans are established and administered in accordance with Minnesota Statutes, Chapters 353 and 356.

PERF members belong to either the Coordinated Plan or the Basic Plan. All MERF employees are covered by the Coordinated Plan where members are covered by Social Security and Basic Plan members are not. All new members must participate in the Coordinated Plan.

PERA provides retirement benefits as well as disability benefits to members, and benefits to survivors upon death of eligible members. Benefits are established by State Statute, and vest after three years of credited service. The defined retirement benefits are based on a member's highest average salary for any five successive years of allowable service, age, and years of credit at termination of service.

NOTES TO THE FINANCIAL STATEMENTS
(CONTINUED)

Two methods are used to compute benefits for PERF's Coordinated Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Coordinated Plan member is 1.2 percent of average salary for each of the first 10 years and 1.7 percent for each remaining year. Under Method 2, the annuity accrual rate is 1.7 percent for Coordinated Plan members for each year of service. For all PERF members whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. A reduced retirement annuity is also available to eligible members seeking early retirement.

There are different types of annuities available to members upon retirement. A normal annuity is a lifetime annuity that ceases upon the death of the retiree—no survivor annuity is payable. There are also various types of joint and survivor annuity options available which will reduce the monthly normal annuity amount, because the annuity is payable over joint lives. Members may also leave their contributions in the fund upon termination of public service in order to qualify for a deferred annuity at retirement age. Refunds of contributions are available at any time to members who leave public service, but before retirement benefits begin.

The benefit provisions stated in the previous paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet are bound by the provisions in effect at the time they last terminated their public service.

PERA issues a publicly available financial report that includes financial statements and required supplementary information for PERA. That report may be obtained by writing to PERA, 60 Empire Drive #200, St. Paul, Minnesota, 55103-2088 or by calling (651) 296-7460 or 1-800-652-9026.

B. Funding Policy

Minnesota Statutes Chapter 353 sets the rates for employer and employee contributions. These statutes are established and amended by the state legislature. MERF makes annual contributions to the pension plan equal to the amount required by state statutes. PERA Coordinated Plan members are required to contribute 5.1% of their annual covered salary. MERF is required to contribute 5.53% of annual covered payroll. MERF's contributions to the Public Employees Retirement Fund for the years ending June 30, 2004, 2003, and 2002 were $13,386, $12,114, and $15,378, respectively. MERF's contributions were equal to the contractually required contributions for each year as set by state statute.

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF FUNDING PROGRESS — LAST SIX YEARS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability Entry Age (b)	Unfunded Actuarial Accrued Liability (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	Unfunded Actuarial Accrued Liability as a % of Covered Payroll (b-a/c)
7-1-99	$ 1,327,660,000	$ 1,434,147,000	$ 106,487,000	93%	$ 64,075,000	166%
7-1-00	1,416,491,000	1,515,963,000	99,472,000	93	54,223,000	183
7-1-01	1,507,159,000	1,615,972,000	108,813,000	93	46,812,000	232
7-1-02	1,540,221,000	1,667,871,000	127,650,000	92	43,461,000	294
7-1-03	1,519,421,000	1,645,921,000	126,500,000	92	40,537,000	312
7-1-04	1,513,388,863	1,643,139,996	129,751,133	92	33,266,242	390

SCHEDULE OF CONTRIBUTIONS FROM EMPLOYERS AND STATE OF MN — LAST SIX YEARS

Year Ended	Actuarially Required Contribution Rate (a)	Actual Covered Payroll (b)	Actual Member Contributions (c)	Annual Required Contributions [(a)x(b)]-(c)=(d)	Actual Employer And State Contributions* (e)	Percentage Contributed (e)/(d)
6-30-99	36.80%	$ 64,075,000	$ 6,938,000	$ 16,641,000	$ 23,279,000	139.89%
6-30-00	34.65	54,223,000	6,069,000	12,719,000	16,662,000	131.00
6-30-01	36.85	46,812,000	5,368,000	11,882,000	17,621,000	148.30
6-30-02	41.78	43,461,000	4,780,000	13,378,000	21,158,000	158.16
6-30-03	46.64	40,537,000	4,167,000	14,739,000	40,199,000	272.73
6-30-04	52.49	33,266,242	3,342,960	14,118,490	45,459,010	321.98

* *Includes amortization obligations not yet paid.*

Required Supplementary Information

Notes to the Schedules of Required Supplementary Information

Information presented in the required supplementary information schedules was determined as part of annual actuarial valuations. Additional information as of the latest actuarial valuation follows.

Valuation Date	July 1, 2004
Actuarial Cost Method	Entry Age
Amortization Method	Level Percent Closed
Remaining Amortization Period	16 years
Asset Valuation Method	Market Value, adjusted for amortization obligations receivable at the end of each fiscal year, less of a percentage of the unrecognized asset return determined at the the close of each of the four preceding fiscal years.
Actuarial Assumptions	
Investment rate of return	
Pre-retirement	6%
Post-retirement	5%
Inflation rate	4%
Projected salary increases	Total reported pay for prior calendar year increased 1.0198% to prior fiscal year and 4% annually for each future year.
Benefit increases after retirement	Annual post-retirement benefit increases incorporate one layer relating to the Consumer Price Index and a second layer relating to investment performance on a five-year, smoothed basis. Over the long term, the methodology is designed to provide increases based on the excess of Fund earnings over 5%.

Significant Plan Provision, Actuarial Methods and Assumption Changes

1998
- A benefit improvement was granted for short service survivors (more than 18 months of service but less than 20 years of service). For survivors with pre-July 1, 1983 effective date, the minimum amount of monthly benefit is raised from $500 to $750. For post-July 1, 1983 effective dates, the current monthly benefit is increased by 15%.

1999
- Disability benefits are to be increased over time at the same rate as MERF retirement annuities rather than at the same rate as annuities payable from the SBI Post Fund.
- Long-service death-while-active survivor benefits are to be increased over time at the same rate as MERF retirement annuities rather than at the same rate as annuities payable from the SBI Post Fund.
- Short-service death-while-active survivor benefits are to be increased over time at the same rate as MERF retirement annuities.
- Active and deferred member survivor benefit provisions are merged into a single provision.
- The Metropolitan Council is authorized to provide an early retirement incentive to individuals employed on January 1, 1999, who meet certain age and years of service requirements. The retirement incentive is an additional .25% in the accrual rate or rates used to compute the benefit, but not to exceed 30 years of service.

2000
- Minnesota Statutes require that the asset value used for actuarial purposes spread differences between actual return (measured on a market-value basis) and expected return on non-RBF(Retirement Benefit Fund) assets over five years, in a manner similar to that already being used within the RBF. The previous method required under Minnesota Statutes recognized one third of the unrealized gains and losses. An Asset Valuation Method requirement exists because market values (which include all unrealized gains and losses) are typically volatile and can produce erratic changes in the contribution requirements from year to year. The intent of the change to the current method is to employ a more effective asset smoothing technique which is market-value based and which eliminates artificial bias related to manager style. The effective date of this requirement is July 1, 2000 with full transition to be accomplished as of July 1, 2003.

2001
- The State has discontinued its annual appropriation to the Plan for the payment of additional lump sum benefits to pre-1973 retirees. Effective January 1, 2002, these annual lump sum benefits will be paid as monthly installments to the retirees.

2002
- An allowance for combined service annuity was accrued for the current year. Liabilities for active members were increased by 0.2% and liabilities for former members were increased by 30% to account for the effect of some participants having eligibility for a Combined Service Annuity.

Supporting Schedules

Schedule of Administrative Expenses — Fiscal Year Ended June 30, 2004

Personnel Services	
Staff salaries	$ 299,274
Payroll taxes	20,349
Pension contributions	13,386
Fringe benefits	24,293
Temporary staffing	320
Contracted services	76,169
Total Personnel Services	433,791
Professional Services	
Actuarial fees	34,596
Audit fees	29,831
Conference and training fees	1,095
Consulting fees	1,375
Data processing	79,464
Legal fees	9,321
Medical exams	4,405
Total Professional Services	160,087
Communications	
Dues, subscriptions and memberships	2,617
Postage	33,741
Printing	11,105
Telephone	5,455
Travel	5,002
Total Communications	57,920
Office Space Rental	49,665
Other	
Equipment and software	1,883
Equipment repair and maintenance	5,420
Insurance	4,560
Supplies	4,626
Total Other	16,489
Total Administrative Expenses	$ 717,952

SUPPORTING SCHEDULES

SCHEDULE OF INVESTMENT EXPENSES

FISCAL YEAR ENDED JUNE 30, 2004

Type of Expense	
Investment managers' fees	$ 3,594,333
Consulting fees	134,147
Custodial/Performance measurement fees	149,850
Other direct investment-related expenses	
Legal fees	4,695
Travel expense	2,847
Total Investment Expenses	$ 3,885,872

SCHEDULE OF PAYMENTS TO CONSULTANTS

FISCAL YEAR ENDED JUNE 30, 2004

Nature of Service	
Actuarial	$ 34,596
Audit	29,831
Consulting	1,375
Legal	9,321
Total Payments to Consultants	$ 75,123

This schedule summarizes payments to outside professionals other than investment advisors. The Investment Section includes a schedule of investment fees.

SUPPORTING SCHEDULES

COMBINING SCHEDULE OF PLAN NET ASSETS

AS OF JUNE 30, 2004

	DAF Active Account	SDF Active Account	Retired Account	Interaccount Elimination	Total
ASSETS					
Cash and Short-term Investments	$ 1,982,833	$ 5,126,780	$ 30,477,434		$ 37,587,047
Receivables					
Accounts receivable, primarily for securities sold	3,421,772	3,322,078	9,535,138	$ (5,797,924)	10,481,064
Variation margins receivable		2,747	27,241		29,988
Contributions receivable	17,146,796	207,355			17,354,151
Accrued interest	104,937	303,170	2,991,541		3,399,648
Dividends receivable		50,217	498,007		548,224
Due from other accounts			8,783,588	(8,783,588)	
Total Receivables	20,673,505	3,885,567	21,835,515	(14,581,512)	31,813,075
Investments, at fair value					
Bonds	62,935,076	39,246,838	389,212,088		491,394,002
Stock		62,788,720	622,677,655		685,466,375
Stock - real estate investment trusts		5,680,315	56,331,858		62,012,173
Mortgages			521,304		521,304
Invested securities lending collateral		8,816,309	87,431,609		96,247,918
Total Investments	62,935,076	116,532,182	1,156,174,514		1,335,641,772
Total Assets	85,591,414	125,544,529	1,208,487,463	(14,581,512)	1,405,041,894
LIABILITIES					
Accounts Payable, Primarily for securities purchased	124,525	2,330,557	23,170,574	(905)	25,624,751
Other Liabilities	2,397,338	3,421,772		(5,797,019)	22,091
Due to Other Accounts	8,783,588			(8,783,588)	
Deferred Premiums on Option Contracts, at fair value		37,442	371,316		408,758
Forward Currency Contracts		1,926	19,097		21,023
Obligations from Securities Lending Collateral		8,816,309	87,431,609		96,247,918
Total Liabilities	11,305,451	14,608,006	110,992,596	(14,581,512)	122,324,541
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 74,285,963	$ 110,936,523	$ 1,097,494,867	$ 0	$ 1,282,717,353

(A Schedule of Funding Progress is presented on page 29)

Supporting Schedules

Combining Schedule of Changes in Plan Net Assets

Fiscal Year Ended June 30, 2004

	DAF Active Account	SDF Active Account	Retired Account	Total
ADDITIONS				
Contributions				
Employer	$ 37,988,170	$ 377,841		$ 38,366,011
State	7,093,000			7,093,000
Employee	3,178,764	164,196		3,342,960
Total Contributions	48,259,934	542,037		48,801,971
Investment Income				
From investing activities				
Net appreciation (depreciation) in fair value of investments	(872,853)	14,573,408	$ 147,589,653	161,290,208
Interest	2,168,169	1,119,385	10,917,140	14,204,694
Dividends		527,899	5,235,190	5,763,089
Other investment income (loss)		351	8	359
	1,295,316	16,221,043	163,741,991	181,258,350
Less investment expense	(409,603)	(255,027)	(3,221,242)	(3,885,872)
Net income from investing activities	885,713	15,966,016	160,520,749	177,372,478
From securities lending activities				
Securities lending income		109,614	1,099,763	1,209,377
Securities lending expense:				
Borrower rebates		(92,146)	(924,557)	(1,016,703)
Management fees		(4,933)	(49,504)	(54,437)
Commissions		(2)	(19)	(21)
Total securities lending expenses		(97,081)	(974,080)	(1,071,161)
Net income from securities lending activities		12,533	125,683	138,216
Total net investment income	885,713	15,978,549	160,646,432	177,510,694
Total Additions	49,145,647	16,520,586	160,646,432	226,312,665
DEDUCTIONS				
Benefits	2,599	10,262,096	126,973,403	137,238,098
Refunds of Contributions	579,783			579,783
Administrative Expenses	717,952			717,952
Total Deductions	1,300,334	10,262,096	126,973,403	138,535,833

(Continued)

COMBINING SCHEDULE OF CHANGES IN PLAN NET ASSETS (CONTINUED)

FISCAL YEAR ENDED JUNE 30, 2004

	DAF Active Account	SDF Active Account	Retired Account	Total
NET INCREASE (DECREASE) BEFORE OTHER CHANGES IN RESERVES	$ 47,845,313	$ 6,258,490	$ 33,673,029	$ 87,776,832
OTHER CHANGES IN RESERVES				
Transfers (to) from Other Accounts				
Survivor retirements	(510,645)	510,645		
Disability retirements	(347,010)	347,010		
Regular retirements	(75,860,924)		75,860,924	
To decrease disability reserve to actuarial requirements	3,378,609	(3,378,609)		
RBF transfer of reserves	(8,783,588)		8,783,588	
Total Other Changes In Reserves	(82,123,558)	(2,520,954)	84,644,512	
NET INCREASE (DECREASE) AFTER OTHER CHANGES IN RESERVES	(34,278,245)	3,737,536	118,317,541	87,776,832
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS				
Beginning of Year	108,564,208	107,198,987	979,177,326	1,194,940,521
End of Year	$ 74,285,963	$ 110,936,523	$ 1,097,494,867	$ 1,282,717,353

SCHEDULE OF CHANGES IN PLAN NET ASSETS – DEPOSIT ACCUMULATION FUND ACTIVE ACCOUNT

	FISCAL YEAR ENDED JUNE 30, 2004
ADDITIONS	
Contributions	
Employer	
City of Minneapolis	$ 28,974,243
Minneapolis Special School District No.1	4,062,808
Minneapolis-St. Paul Metropolitan Airports Commission	4,946,563
Minnesota State Colleges and Universities	4,556
Total Employer Contributions	37,988,170
State	
Amortization of unfunded liability	7,093,000
Total State Contributions	7,093,000
Employee	
Retirement	3,178,764
Total Employee Contributions	3,178,764
Total Contributions	48,259,934
Investment Income	
From investing activities	
Net appreciation (depreciation) in fair value of investments	(872,853)
Interest	2,168,169
	1,295,316
Less investment expense	
Investment managers' fees	(396,591)
Custodial/performance measurement fees	(13,012)
Net income from investing activities	885,713
Total net investment income	885,713
Total Additions	49,145,647

(CONTINUED)

SCHEDULE OF CHANGES IN PLAN NET ASSETS – DEPOSIT ACCUMULATION FUND ACTIVE ACCOUNT (CONTINUED)

	FISCAL YEAR ENDED JUNE 30, 2004
DEDUCTIONS	
Benefits	$ 2,599
Refunds of Contributions	579,783
Administrative Expenses	717,952
Total Deductions	1,300,334
NET INCREASE BEFORE OTHER CHANGES IN RESERVES	47,845,313
OTHER CHANGES IN RESERVES	
Transfer (to) from Survivor Benefits Reserve	
Survivor retirements	(510,645)
Transfers (to) from Disability Retirements Reserve	
Disability retirements	(347,010)
To decrease assets to actuarial requirements	3,378,609
Transfers (to) from Retirement Benefits Reserve	
Regular retirements	(75,860,924)
RBF transfer of reserves	(8,783,588)
Total Other Changes In Reserves	(82,123,558)
NET DECREASE AFTER OTHER CHANGES IN RESERVES	(34,278,245)
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	
Beginning of Year	108,564,208
End of Year	$ 74,285,963

SCHEDULE OF CHANGES IN PLAN NET ASSETS – SURVIVOR AND DISABILITY FUND ACTIVE ACCOUNT

FISCAL YEAR ENDED JUNE 30, 2004

ADDITIONS	
Contributions	
Employer	
Survivor benefits	$ 377,841
Total Employer Contributions	377,841
Employee	
Survivor benefits	164,196
Total Employee Contributions	164,196
Total Contributions	542,037
Investment Income	
From investing activites	
Net appreciation (depreciation) in fair value of investments	14,573,408
Interest	1,119,385
Dividends	527,899
Other investment income (loss)	351
	16,221,043
Less investment expense	
Investment managers' fees	(234,111)
Custodial/performance measurement fees	(8,644)
Consulting fees	(11,591)
Other direct investment-related expenses	(681)
Net income from investing activities	15,966,016

(CONTINUED)

SUPPORTING SCHEDULES

SCHEDULE OF CHANGES IN PLAN NET ASSETS – SURVIVOR AND DISABILITY FUND ACTIVE ACCOUNT (CONTINUED)

	FISCAL YEAR ENDED JUNE 30, 2004
From securities lending activities	
Securities lending income	$ 109,614
Securities lending expense:	
Borrower rebates	(92,146)
Management fees	(4,933)
Commissions	(2)
Total securities lending expenses	(97,081)
Net income from securities lending activities	12,533
Total net investment income	15,978,549
Total Additions	16,520,586
DEDUCTIONS	
Benefits	
Disability	5,918,787
Survivor	4,343,309
Total Deductions	10,262,096
NET INCREASE BEFORE OTHER CHANGES IN RESERVES	6,258,490
OTHER CHANGES IN RESERVES	
Transfers (to) from Deposit Accumulation Reserve	
Survivor retirements	510,645
Disability retirements	347,010
To decrease assets to actuarial requirements	(3,378,609)
Total Other Changes In Reserves	(2,520,954)
NET INCREASE AFTER OTHER CHANGES IN RESERVES	3,737,536
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	
Beginning of Year	107,198,987
End of Year	$ 110,936,523

Supporting Schedules

Schedule of Changes in Plan Net Assets – SDF Active Account -- Survivor Benefits Reserve

Fiscal Year Ended June 30, 2004

ADDITIONS	
Contributions	
Employer	$ 377,841
Employee	164,196
Total Contributions	542,037
Investment Income	
From investing activites	
Net appreciation (depreciation) in fair value of investments	14,573,408
Interest	1,119,385
Dividends	527,899
Other investment income (loss)	351
	16,221,043
Less investment expense	
Investment managers' fees	(234,111)
Custodial/performance measurement fees	(8,644)
Consulting fees	(11,591)
Other direct investment-related expenses	(681)
Net income from investing activities	15,966,016
From securities lending activities	
Securities lending income	109,614
Securities lending expense:	
Borrower rebates	(92,146)
Management fees	(4,933)
Commissions	(2)
Total securities lending expenses	(97,081)
Net income from securities lending activites	12,533
Total net investment income	15,978,549
Total Additions	16,520,586

(Continued)

SCHEDULE OF CHANGES IN PLAN NET ASSETS – SDF ACTIVE ACCOUNT -- SURVIVOR BENEFITS RESERVE (CONTINUED)

FISCAL YEAR ENDED JUNE 30, 2004

DEDUCTIONS	
Benefits	$ 4,343,309
NET INCREASE BEFORE OTHER CHANGES IN RESERVES	12,177,277
OTHER CHANGES IN RESERVES	
Transfer (to) from Deposit Accumulation Reserve	
Survivor retirements	
Employers' reserves	
Minneapolis Special School District No 1	510,645
Transfer (to) from Disability Retirement Reserve	
Income allocation	(9,885,773)
Total Other Changes In Reserves	(9,375,128)
NET INCREASE AFTER OTHER CHANGES IN RESERVES	2,802,149
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	
Beginning of Year	40,971,987
End of Year	$ 43,774,136

SCHEDULE OF CHANGES IN PLAN NET ASSETS – SDF ACTIVE ACCOUNT -- DISABILITY RETIREMENTS RESERVE

FISCAL YEAR ENDED JUNE 30, 2004

ADDITIONS	
DEDUCTIONS	
Benefits	$ 5,918,787
NET DECREASE BEFORE OTHER CHANGES IN RESERVES	(5,918,787)
OTHER CHANGES IN RESERVES	
Transfers (to) from Deposit Accumulation Reserve	
Diability retirements	
Employees' reserves	115,006
Employers' reserves	
City of Minneapolis	232,004
To decrease assets to actuarial requirements	(3,378,609)
Transfers (to) from Survivor Benefit Reserve	
Income allocation	9,885,773
Total Other Changes In Reserves	6,854,174
NET INCREASE AFTER OTHER CHANGES IN RESERVES	935,387
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	
Beginning of Year	66,227,000
End of Year	$ 67,162,387

SUPPORTING SCHEDULES

SCHEDULE OF CHANGES IN PLAN NET ASSETS – RETIRED ACCOUNT

FISCAL YEAR ENDED JUNE 30, 2004

ADDITIONS	
Investment Income	
From investing activities	
Net appreciation (depreciation) in fair value of investments	$ 147,589,653
Interest	10,917,140
Dividends	5,235,190
Other investment income (loss)	8
	163,741,991
Less investment expense	
Investment managers' fees	(2,963,631)
Custodial/performance measurement fees	(128,194)
Consulting fees	(122,556)
Other direct investment-related expenses	(6,861)
Net income from investing activities	160,520,749
From securities lending activities	
Securities lending income	1,099,763
Securities lending expense:	
Borrower rebates	(924,557)
Management fees	(49,504)
Commissions	(19)
Total securities lending expenses	(974,080)
Net income from securities lending activities	125,683
Total net investment income	160,646,432
Total Additions	160,646,432
DEDUCTIONS	
Benefits	126,973,403
NET INCREASE BEFORE OTHER CHANGES IN RESERVES	33,673,029

(CONTINUED)

SCHEDULE OF CHANGES IN PLAN NET ASSETS – RETIRED ACCOUNT (CONTINUED)

FISCAL YEAR ENDED JUNE 30, 2004

OTHER CHANGES IN RESERVES	
Transfers (to) from Deposit Accumulation Reserve	
Regular retirements	
Employees' reserves	$ 23,124,432
Employers' reserves	
City of Minneapolis	36,549,349
Minneapolis Special School District No. 1	14,475,518
Minneapolis-St. Paul Metropolitan Airports Commission	1,711,625
RBF transfer of reserves	8,783,588
Total Other Changes In Reserves	84,644,512
NET INCREASE AFTER OTHER CHANGES IN RESERVES	118,317,541
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	
Beginning of Year	979,177,326
End of Year	$ 1,097,494,867

REPORT ON INVESTMENT ACTIVITY
(UNAUDITED)

ENNISKNUPP

November 3, 2004

Members of the Retirement Board
Minneapolis Employees Retirement Fund

As independent investment consultant to the Board of Minneapolis Employees Retirement Fund ("MERF"), we comment here on three aspects of investment: results during the most recent fiscal year, policy and oversight.

Investment Results. The latter half of 2003 proved a strong market for global equities. The bond market earned modest, but positive returns. This combination proved beneficial, as the Total Fund earned a 16.5% return during the fiscal year ending June 30, 2004. While positive, the return lagged that of its benchmark due primarily to underperformance within the non-U.S. stock component of the program. The Fund's one-year return did exceed the median rate of return for other public pension plans, which was 16.2%. The Fund's long-term returns remain solid. Its ten-year return of 9.1% approximated that of its performance benchmark and ranks near the median of the public fund universe.

The Funds' investment results, as presented in this report, fairly represent, in our judgment, the performance of MERF. All measurements and comparisons have been made using standard performance evaluation methods, and results are presented in a manner consistent with the presentation standards of the CFA Institute.

Investment Policy. The MERF Funds are managed under well-articulated investment policies, which, in our opinion, are appropriate to the circumstances of MERF and its members. Investment policy is progressive, yet prudent. The policies ensure diversification and exhibit attention to risk control. Throughout the year the Trustees and Executive Director have taken appropriate measures to ensure that Fund investments have conformed with the Board's policies.

Report on Investment Activity

(UNAUDITED/CONTINUED)

Prudent Oversight. While delegating day-to-day investment management responsibility to various professional investment firms, the Trustees retain the responsibility to monitor all aspects of MERF's investments. In our opinion, the Trustees have established and executed an appropriately comprehensive process for overseeing MERF investments. Through regular reviews by the Trustees themselves, quarterly performance appraisals by an independent firm, periodic consultation with the MERF Investment Advisory Panel, and the day-to-day oversight activities of the Executive Director, the Board has achieved a high degree of awareness and critical oversight of the investments.

Very truly yours,

Suzanne M. Bernard

Suzanne Bernard, CFA
Principal

CERTIFICATE OF ACHIEVEMENT

OUTLINE OF INVESTMENT POLICIES (UNAUDITED)

Asset Allocation
The MERF Board has authorized staff to maintain the proportion of the Fund's investments according to the policy percentages specified below. Rebalancing of investments back to policy percentages will be accomplished on a quarterly basis.

	Active Fund		Retired Fund	
Asset Class	%	Range	%	Range
Cash Equivalents	0	0-1%	0	0-1%
Equities				
U.S. Equities	45	43-49%	45	43-49%
Non-U.S. Equities	20	18-22%	20	18-22%
Fixed Income (including mortgages)	30	28-32%	30	28-32%
Real Estate	5	3-5%	5	3-5%
	100		100	

Equity Structure
U.S. Equities -
- The current structure for investment in U. S. equities is 70% passive (index-linked), 20% enhanced index and 10% active management.
- The benchmark for the aggregate U.S. equity investments is the Russell 3000 Index.
- The U.S. equity portfolio is structured so that the risk characteristics of the aggregate fund do not have significant biases relative to the Russell 3000 Index.
- In the event that an active investment manager cannot be identified who is expected to perform better than a passive investment manager, after fees, the passive approach may be substituted for an active approach.

Non-U.S. Equities -
- Approximately 33% of developed market investments are index-linked and the other 67% are actively managed to attempt to generate returns exceeding those of the overall market. Currently, 8% of non-U.S. equities are actively invested in emerging market equities.
- The overall benchmark for non-U.S. equities is the Morgan Stanley All Country Ex-U.S. Index. The 8% investment in emerging markets is benchmarked to the IFC (International Finance Corporation) Emerging Markets Custom Index.

Fixed Income Structure
- The current structure for investment in fixed income securities is 100% active management.
- The benchmark for investment managers, as well as for the aggregate portfolio, is the Lehman Brothers Aggregate Bond Index.
- Active investment managers are granted broad authority, within investment guidelines, to invest in global fixed income securities.

Performance Measurement
Time-weighted rates of return are calculated on a quarterly basis by an outside firm. Rates of return are used to measure performance of the Active and Retired Accounts, as well as investment managers. Comparisons are made to Fund objectives, performance benchmarks and appropriate peer universes.

Manager Selection and Retention
MERF's investment consultant conducts searches on an as needed basis for qualified investment management firms as directed by the Board. A mininum of four qualified managers are identified by MERF's consultant and after interview by the Board, the Board selects the manager that it deems to be best qualified. Reasons for termination of managers include: changes in investment style and discipline; changes in the firm which may detract from future performance; changes in MERF policy which eliminate the need for the manager; and loss of confidence that the firm will add value, as evidenced by failure to perform historically over a three to five-year period relative to their benchmark.

Certificate of Achievement

Investment Results (unaudited)

	Year Ended 6-30-04	Annualized 3-Year	Annualized 5-Year
DEPOSIT ACCUMULATION FUND ACTIVE ACCOUNT			
Cash and Short-term Investments	65.0%		
Bonds	0.8		
Benchmark: Marketable Bonds	*0.8*		
OVERALL RETURN - DAF ACTIVE ACCOUNT	0.8		
SURVIVOR AND DISABILITY FUND ACTIVE ACCOUNT/RETIRED ACCOUNT COMBINED			
Short-term Investments	(2.2)	1.0%	3.5%
Benchmark: 90 Day Treasury	*1.0*	*1.7*	*3.3*
Bonds	3.4	7.9	8.0
Benchmark: Fixed Income Policy	*2.7*	*7.2*	*7.5*
Stocks - Domestic	20.5	(1.9)	(1.7)
Benchmark: Russell 3000 Index	*20.5*	*0.1*	*(1.1)*
Stocks - International	28.0	4.2	0.2
Benchmark: Morgan Stanley Cap. International All Country Ex-US Index	*32.0*	*4.9*	*0.6*
Real Estate	29.0	16.5	16.4
Benchmark: Custom Real Estate Index	*27.5*	*15.4*	*15.6*
OVERALL RETURN - SDF ACTIVE/RETIRED COMBINED	16.5	3.5	2.7

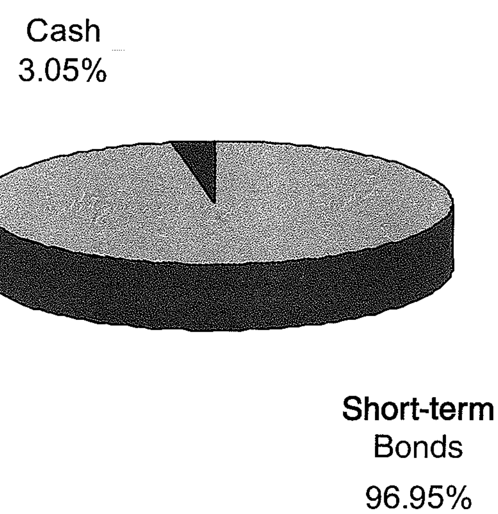
Source: Ennis, Knupp & Associates, Chicago, IL. For performance measurement purposes, certain investment holdings are classified based upon their characteristics, rather than on their actual investment type (i.e., limited partnerships included as part of the real estate classification because they have invested primarily in real estate).

Footnote: The calculations were prepared using a time-weighted rate of return based on the market rate of return in accordance with the Association for Investment Management and Research's Performance Presentation Standards. Investment results are presented gross, with the exception of the Overall Return, which are presented net of fees.

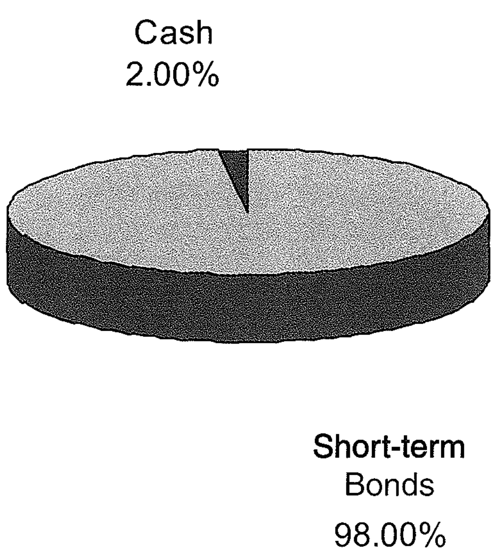
The Deposit Accumulation Fund Active Account was created in June 2003, therefore, there was no annualized rates of return.

ASSET ALLOCATION - DAF ACTIVE ACCOUNT (UNAUDITED) AS OF JUNE 30, 2004

Actual

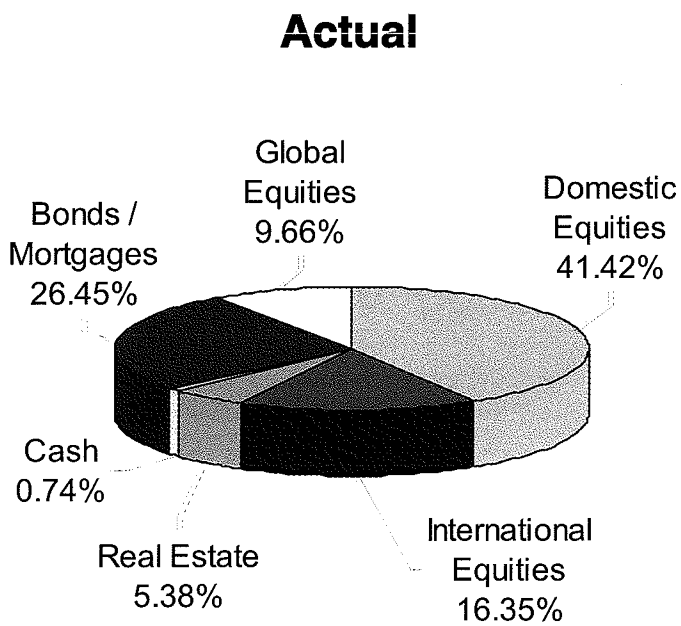


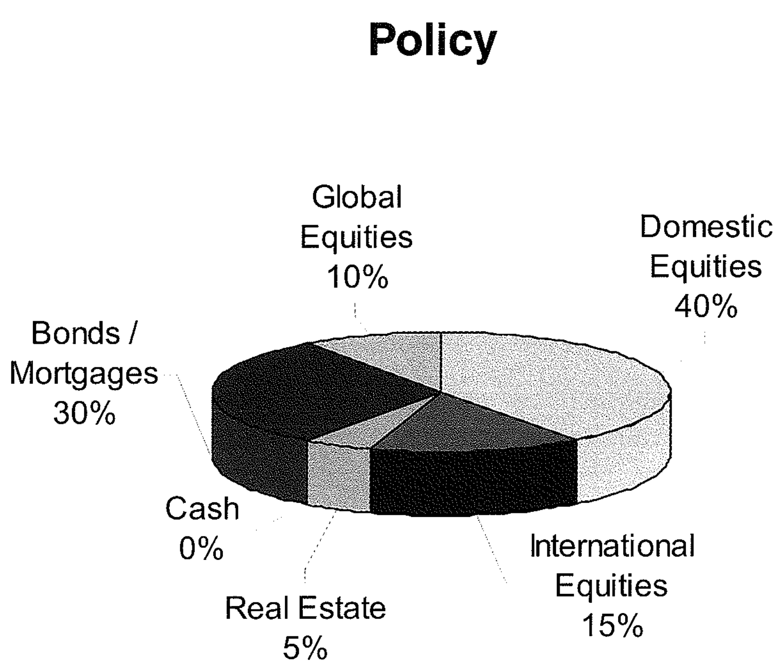
Policy



Note: For asset allocation purposes, certain investment holdings are classified based upon their characteristics, rather than on their actual investment type (i.e., limited partnerships included as part of the real estate classification because they have invested primarily in real estate).

ASSET ALLOCATION - SDF ACTIVE/RETIRED COMBINED (UNAUDITED) AS OF JUNE 30, 2004





Note: For asset allocation purposes, certain investment holdings are classified based upon their characteristics, rather than on their actual investment type (i.e., limited partnerships included as part of the real estate classification because they have invested primarily in real estate).

LISTINGS OF LARGEST ASSETS HELD

(UNAUDITED)

TOP TEN STOCK HOLDINGS

AS OF JUNE 30, 2004

Shares or Units	Stocks	Fair Value
34,970,706	State Street Russell 3000 Index Fund	$ 315,890,389
12,010,571	Capital Guardian All Country World Equity Fund	116,142,220
2,263,051	Wellington International Research Equity Fund	56,644,162
2,132,335	Bank Ireland Asset Management International Equity Fund	51,319,758
426,310	State Street United Kingdom MSCI Fund	18,778,516
2,341,656	State Street Japan MSCI Fund	18,035,432
134,572	State Street France MSCI Fund	7,121,799
89,413	State Street Switzerland MSCI Fund	5,348,947
122,317	State Street German MSCI Fund	5,151,610
93,300	Simon Property Group, Inc.	4,797,486

A complete listing of portfolio holdings is available from the MERF office, upon request.

TOP TEN BOND HOLDINGS

AS OF JUNE 30, 2004

Par or Units	Bonds	Fair Value
193,256	PIMCO Stockplus Fund	$ 111,746,665
6,176,161	PIMCO Low Duration Open End Fund	62,935,076
30,770,000	U.S. Treasury Bond Inflation Index Linked, 3.875%, 4/15/2029	44,722,900
37,680,000	United States Treasury Notes Bond Inflation Indexed, 3.0%, 7/15/2012	42,644,946
30,100,000	U.S. Treasury Notes Inflation-Indexed Note, 3.5%, 1/15/2011	36,096,047
15,610,000	U.S. Treasury Notes Inflation Index, 3.875%, 1/15/2009	19,946,893
17,790,000	U.S. Treasury Inflation Indexed Bonds, 1.875%, 7/15/2013	18,028,829
5,000,000	U.S. Treasury Notes DTD 1/18/2000 Inflation Indexed, 4.25%, 1/15/2010	6,381,450
6,040,000	U.S. Treasury Notes Treasury Inflation Indexed Notes, 2.0%, 1/15/2014	6,121,751
4,700,000	U.S. Treasury Notes Inflation Index, 3.625%, 1/15/2008	5,976,849

A complete listing of portfolio holdings is available from the MERF office, upon request.

SCHEDULES OF INVESTMENT FEES AND COMMISSIONS (UNAUDITED)

INVESTMENT FEES

	Fees for the Fiscal Year Ended June 30, 2004	Assets (at Fair Value) Under Management as of June 30, 2004
Investment Managers' Fees		
Bond managers	$ 1,317,598	$ 491,394,002
Deutsche Asset Management		
Pacific Investment Management Co.		
Western Asset Management		
Stock managers	2,276,735	747,478,548
Lend Lease Rosen		
Bank of Ireland Management Group Trust		
Capital Guardian Trust Company		
Deutsche Asset Management		
Private Capital Management		
State Street Global Advisors		
Strong Capital Management, Inc.		
Wellington Management Co.		
Custodial fees/performance measurement fees - Northern Trust	149,850	
Consulting fees - Ennis, Knupp & Associates	134,147	
Other Direct Investment-related Fees and Expenses		
Legal fees	4,695	
Travel expense	2,847	
Total	$ 3,885,872	

COMMISSIONS

FISCAL YEAR ENDED JUNE 30, 2004

	Number of Shares Traded	Total Commissions	Commissions Per Share (in cents)
Lend Lease Rosen	1,042,838	$ 40,464	3.88
Private Capital Management	1,984,318	158,783	8.00
Strong Capital Management, Inc.	6,128,595	162,998	2.66
Miscellaneous	77,640		

Due to the large number of brokerage firms used by each investment manager, information for this schedule has been summarized by investment manager. A complete listing of brokerage firms is available from the MERF office, upon request.

INVESTMENT SUMMARY (UNAUDITED)

INVESTMENTS

AS OF JUNE 30, 2004

Type of Investment	Fair Value	Percent of Total Fair Value
Short-term Investments		
Pooled government securities cash fund	$ 37,563,791	2.74%
Bonds		
Corporate convertible bonds	111,746,664	8.13
Government/agency bonds	11,409,023	0.83
Municipal bonds	8,844,351	0.64
Corporate bonds	103,001,339	7.50
Government mortgage backed securities	28,523,873	2.08
Government issued commercial mortgage-backed	1,774,012	0.13
Commercial mortgage-backed	996,156	0.07
Asset backed securities	17,212,891	1.25
Non-government backed c.m.o.s	13,115,376	0.96
Index linked government bonds	194,770,317	14.18
Total Bonds	491,394,002	35.77
Common Stock		
Domestic	545,780,953	39.75
International	139,685,422	10.17
Total Stock	685,466,375	49.92
Stock - Real Estate Investment Trusts	62,012,173	4.52
Mortgages	521,304	0.04
Invested Securities Lending Collateral	96,247,918	7.01
Total Investments	$ 1,373,205,563	100.00%

ACTUARY'S CERTIFICATION LETTER

SEGAL

THE SEGAL COMPANY
6300 S. Syracuse Way Suite 750 Englewood, CO 80111-7302
T 303.714.9900 F 303.714.9990 www.segalco.com

November 4, 2004

Ms. Agnes Gay, President,
and Members of the Retirement Board
Minneapolis Employees Retirement Fund
706 Second Avenue South
800 Baker Building
Minneapolis, Minnesota 55402

DIRECT DIAL NUMBER
303-714-9936
WRITER'S E-MAIL ADDRESS
lthompson@segalco.com

Members of the Board:

We have completed the annual valuation of the Minneapolis Employees Retirement Fund as of July 1, 2004. The purpose of this valuation is to determine the financial status of the Plan. To achieve this purpose, an actuarial valuation is made at the beginning of each fiscal year as required by Section 356.215 of Minnesota Statutes.

The financing objective of the Fund is to be fully funded by the year 2020. In addition to the required employee and employer contributions, current laws require an annual contribution from the State to assure realization of this objective. The current funding level (the ratio of actuarial assets to the liability) is 92.10%.

The valuation uses the entry age normal cost method, with normal cost expressed as a level percentage of earnings. The required contribution under Chapter 356 consists of the normal cost, a supplemental contribution which will amortize the unfunded accrued liability as a level dollar amount by the year 2020, and an allowance for expenses.

The actuarial valuation was based upon applicable statutory provisions and Standards for Actuarial Work in effect on July 1, 2004. Primary actuarial assumptions include a pre-retirement interest rate of 6.0%, a post-retirement interest rate of 5.0%, a salary scale of 4.0% and other assumptions regarding mortality, disability, retirement, and withdrawal, which are consistent with the latest experience analysis. Actual plan costs will vary to the extent that actual plan experience varies from these assumptions.

Effective with the July 1, 2000 valuation of the fund, Minnesota Statutes require that the asset value used for actuarial purposes spread differences between actual return (measured on a market-value basis) and expected return on non-RBF (Retirement Benefit Fund) assets over five years. An Asset Valuation method requirement exists because market values (which include all unrealized gains and losses) are typically volatile and can produce erratic changes in the contribution requirements from year to year. The intent of the change to the current method is to employ a more effective asset smoothing technique which is market-value based and which eliminates artificial volatility in the contribution rate.

ACTUARY'S CERTIFICATION LETTER (CONTINUED)

Ms. Agnes Gay, President,
November 4, 2004
Page 2

These assumptions meet the parameters set by the Government Accounting Standards Board Statement Number 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans.*

Supporting schedules and trend data schedules shown in the Actuarial Section of this financial report were prepared by The Segal Company.

The Schedule of Funding Progress shown in the Financial Section of this financial report was prepared by The Segal Company. Segal determined the amount of Annual Required Contributions shown in the Schedule of Contributions From Employers and State of Minnesota in the Financial Section of this financial report.

Although we have reviewed the data for reasonableness and consistency, we have relied on the basic employee data and asset figures, along with revisions as submitted by the Minneapolis Employees Retirement Fund. This employee and asset information form the basis for our valuation and to the extent that actual data differs from that submitted for purposes of the valuation, results may vary from those shown in the report.

We certify that to the best of our knowledge and belief this actuarial valuation was performed in accordance with the requirements of Section 356.215, Minnesota Statutes, and the requirements of the Standards for Actuarial Work.

Respectfully submitted,

Leslie L. Thompson, FSA, MAAA, EA
Senior Vice President and Actuary

/kls

138938/05776.016

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS

The following actuarial assumptions and methods are specified by state law. Proposed changes must be approved by the Legislative Commission on Pensions and Retirement.

Investment Return Rate
6% per annum for pre-retirement and 5% per annum for post-retirement. (Adopted 1991)

Asset Valuation Method
Market Value, adjusted for amortization obligations receivable at the end of each fiscal year, less of a percentage of the Unrecognized Asset Return determined at the close of each of the four preceding fiscal years. Unrecognized Asset Return is the difference between actual net return on Market Value of Assets and the asset return expected during that fiscal year (based on the assumed interest rate employed in the July 1 Actuarial Valuation of the fiscal year). Transition rules apply between July 1, 2000 and July 1, 2003, when the method is fully in effect. (Adopted 2000)

Mortality
Average of male and female rates of the 1986 Projected Experience Table with a one-year age setback, assuming equal distribution of males and females. (Adopted 1985)

Retirement Age
61 years, or if older than age 61, one year from the valuation date. (Adopted 1984)

Pre-retirement Termination Rates
Average of male and female rates of the 1986 Projected Experience Table with a one-year age setback, assuming equal distribution of males and females. (Adopted 1985)

Separations Expressed as the Number of Occurrences per 10,000

Age	Death	Withdrawal	Disability
20	10	2,100	21
25	8	1,100	21
30	9	500	23
35	11	150	30
40	14	100	41
45	19	100	61
50	30	100	93
55	47	100	160
60	79	100	0
65	140	0	0
70	241	0	0

Salary Increases
Total reported pay for prior calendar year increased 1.0198% to prior fiscal year and 4% annually for each future year, which is the portion of the increase assumption attributable to inflation. (Adopted 1991)

Actuarial Cost Method
Entry age normal actuarial cost method with normal costs expressed as a level percentage of earnings. Under this method, actuarial gains (losses) reduce (increase) the unfunded actuarial accrued liability. (Used in all valuations since 1959)

Benefit Increases After Retirement
Payment of increases based on the excess of Retired Account earnings over 5% are accounted for by using a 5% post-retirement interest assumption. (Adopted by Legislative action in 1973)

Administrative Expenses
Prior year administrative expenses (excluding investment expenses) increased by 4% and expressed as a percentage of projected annual payroll. (Adopted by Legislative action in 1991)

Investment Expenses
Investment expenses for the fiscal year ended June 30, 1992 are being amortized over 28 years.

Allowance for Combined Service Annuity
Liabilities for active members are increased by 0.2% and liabilities for former members are increased by 30% to account for the effect of some participants having eligibility for a Combined Service Annuity.

Return of Contributions
All members withdrawing after becoming eligible for a deferred benefit were assumed to take the larger of their contributions accumulated with interest or the value of their deferred benefit. (Adopted 1987)

Payment On The Unfunded Actuarial Accrued Liability
A level dollar amount each year to the statutory amortization date, adjusted for timing of expected receipt. Employers are assumed to contribute 73% of billed contribution amounts on a monthly basis during the plan year. The remaining 27% of contributions are assumed to be deferred to payment in subsequent plan years. (Adopted 1981; amended in 1991 to extend the time from December 31, 2017 to June 30, 2020)

Family Composition
67% of members are assumed to be married. Females are assumed to be three years younger than males.

Experience Studies
The most recent experience study was dated March 1995; no changes to existing actuarial assumptions were proposed.

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

LAST SIX YEARS

Valuation Date	Number of Active Members	Annual Payroll	Average Annual Earnings	Percent Increase In Average Earnings	Number of Participating Employers
7-1-99	1,363	$ 64,065,000	$ 47,003	8.1 %	6
7-1-00	1,152	55,784,000	48,423	3.0	6
7-1-01	959	46,338,000	48,319	(0.2)	6
7-1-02	836	43,079,000	51,530	6.7	6
7-1-03	705	36,692,000	52,045	1.0	6
7-1-04	552	31,019,951	56,196	8.0	6

SCHEDULE OF RETIRANTS AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

LAST SIX YEARS

Year Ended	Added to Rolls		Removed from Rolls		Cost of Living Adjustment	End of Year		Percent Increase In Annual Benefit	Average Annual Benefit
	No.	Annual Benefit	No.	Annual Benefit		No.	Annual Benefit		
6-30-99	248	$ 5,961,000	206	$ 3,151,000	$ 6,540,000	4,950	$ 99,756,000	10.4 %	$ 20,153
6-30-00	273	6,997,000	197	3,134,000	9,549,000	5,026	113,168,000	13.4	22,516
6-30-01	270	6,877,000	253	4,495,000	10,898,000	5,043	126,448,000	11.7	25,074
6-30-02	201	5,303,000	223	4,359,000	5,995,000	5,021	133,387,000	5.5	26,566
6-30-03	207	6,460,000	268	6,002,000	1,210,000	4,960	135,055,000	1.3	27,229
6-30-04	224	6,426,174	203	4,944,595	2,032,758	4,981	138,569,337	2.6	27,820

SOLVENCY TEST

LAST SIX YEARS

Valuation Date	Aggregate Accrued Liabilities For (1) Active Member Contributions	(2) Retirees and Beneficiaries	(3) Active Members (Employer Financed Portion)	Reported Assets	Portion of Accrued Liabilities Covered by Reported Assets (1)	(2)	(3)
7-1-99	$ 142,610,000	$ 1,001,430,000	$ 290,107,000	$ 1,327,660,000	100%	100%	63%
7-1-00	128,944,000	1,141,457,000	245,562,000	1,416,491,000	100	100	59
7-1-01	115,161,000	1,280,531,000	220,280,000	1,507,159,000	100	100	51
7-1-02	109,275,000	1,342,561,000	216,035,000	1,540,221,000	100	100	41
7-1-03	99,540,000	1,358,769,000	187,612,000	1,519,421,000	100	100	33
7-1-04	83,208,387	1,403,704,115	156,227,494	1,513,388,863	100	100	17

ANALYSIS OF FINANCIAL EXPERIENCE

LAST SIX YEARS

Actuarial Gains (Losses) in Accrued Liabilities Resulting from Differences Between Assumed Experience and Actual Experience (dollars in thousands)

	Fiscal Year Ended June 30th					
Type of Activity	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Salary Increases If there are smaller salary increases than assumed, there is a gain. If greater increases, a loss.	$(16,061)	$ 14,097	$ 149	$ (7,831)	$ 7,515	$ 2,145
Investment Income If there is greater investment income than assumed, there is a gain. If less income, a loss.	61,588	13,376	5,538	(7,714)	(15,763)	(17,865)
Death After Retirement/Mortality If retirants live longer than assumed, there is a loss. If not as long, a gain.	(2,614)	(3,086)	7,186	6,181	(10,513)	(4,723)
Other Items Miscellaneous gains and losses resulting from data adjustments, timing of financial transactions, valuation methods, etc.	(13,521)	(19,478)	(25,640)	(15,073)	(8,230)	1,872
Age & Service Retirements If members retire at older ages or with lower final average pay than assumed, there is a gain. If younger ages or higher average pay, a loss.	*	*	*	*	*	(9,262)
Cost of Living Adjustments Different Than Assumed	*	*	*	*	*	(9,436)
Gain (Loss) During Year From Financial Experience	29,392	4,909	(12,767)	(24,437)	(26,991)	(37,269)
Non-recurring Items Adjustments for plan amendments, etc.				(4,342)		
Composite Gain (Loss) During Year	$ 29,392	$ 4,909	$ (12,767)	$ (28,779)	$ (26,991)	$ (37,269)

* *Included in "Other Items" classification.*

Summary of Plan Provisions

Eligibility

- Employee membership in the Minneapolis Employees Retirement Fund is restricted by law to those employees hired prior to July 1, 1978. Employees hired after June 30, 1978 are required to become members of the Minnesota Public Employees Retirement Association.

- Effective July 1, 1992, licensed peace officers and firefighters who are employed by the Metropolitan Airports Commission and covered by MERF will receive the greater of retirement, disability or survivor benefits computed under MERF or the Public Employees Retirement Association (PERA) Police & Fire Plan, as amended by the Pension Uniformity Act of 1997.

Contributions

- *Members*—members contribute 9.25% of salary into the Deposit Accumulation Reserve and .50% of salary (subject to annual adjustment) into the Survivor Benefits Reserve.

- *Employers*—employers contribute any excess of normal cost contributions of 9.75% of salary. The unfunded actuarial liability is funded partially by payments each year of 2.68% of salary plus $3,900,000 from all employers. The State of Minnesota's annual contribution is determined as the lesser of the remaining payments or $9,000,000. If the value of the remaining payments is greater than $11,910,000, the excess is reallocated to the employers. If the value is less than $11,910,000, no additional payment is required.

Allowable Service

Service during which member contributions are made.

Average Salary

Average of the five highest calendar years of salary out of the last ten calendar years.

Normal Retirement Benefit

- After attainment of age 60 and ten years of service, or any age with the completion of 30 years of service.

- Benefit amount is 2.00% of average salary for the first ten years of allowable service plus 2.50% of average salary for each subsequent year of allowable service.

- Annual post-retirement benefit increases incorporate one layer relating to the Consumer Price Index and a second layer relating to investment performance on a smoothed basis. Over the long term, the methodology is designed to provide increases based on the excess of Fund earnings over 5%.

Disability Benefit

- Eligible if total and permanent disability occurs before age 60 with five years of allowable service. No allowable service is required if disability is work-related.

- Benefit amount is 2.00% of average salary for the first ten years of disability service plus 2.50% of average salary for each subsequent year of disability service. Disability service is the greater of allowable service or allowable service projected to age 60, subject to a maximum of 22 years. Benefits are reduced by Workers' Compensation benefits.

Survivor Death Benefit

- *Death of Active Member with Less than 20 Years of Allowable Service*—the beneficiary is entitled to a full refund of the member's contributions. In addition, if the deceased member had completed a minimum of 18 months of allowable service, the surviving spouse would receive 30% of the member's average salary over the last six months of service preceding death and each surviving child would receive 10%. The maximum family benefit cannot exceed $900 per month.

- *Death of Active Member with Over 20 Years of Allowable Service*—the monthly benefit is the actuarial equivalent of a single life annuity which would have been paid as a retirement benefit on the date of death without regard to eligibility age for retirement benefit. If there is no surviving spouse, the beneficiary may be a dependent child or dependent parent.

Refund of Contributions

Upon termination of public service, member is entitled to a refund of contributions plus interest.

Deferred Benefit

After completion of three years service, member may elect a deferred annuity to commence any time after attainment of age 60. The annuity is computed under laws in effect at the time of termination and is increased by 3% per year from the date service terminated to the date annuity payments begin.

A more detailed description of plan provisions is available from the MERF Office, upon request

SCHEDULE OF REVENUE BY SOURCE (UNAUDITED) — LAST SIX YEARS

Year Ended	Employee Contributions	Employer Contributions: Dollars	Employer Contributions: % of Annual Covered Payroll	Net Investment Income	State Amortization Contribution	State Lump Sum Contribution	Total
6-30-99	$ 6,937,655	$ 14,722,996	23.0%	$ 170,419,238	$ 7,032,750	$ 524,653	$ 199,637,292
6-30-00	6,069,060	13,013,923	24.0	155,916,729	3,085,000	510,647	178,595,359
6-30-01	5,368,087	11,233,852	24.0	(101,820,058)	3,224,000	483,729	(80,214,208)
6-30-02	4,779,661	12,260,956	28.2	(101,764,825)	4,510,000	0	(81,492,208)
6-30-03	4,167,298	38,102,470	94.0	19,653,733	6,632,000	0	68,555,501
6-30-04	3,342,960	38,366,011	115.3	177,510,694	7,093,000	0	226,312,665

Note: The actual employer contribution of $38,366,011 for FY2004, included an additional contribution of $30,845,888 (that was not part of the actuarial requirement) paid by the employers to fund the cost of new retirements for the year.

SCHEDULE OF EXPENSES BY TYPE (UNAUDITED) — LAST SIX YEARS

Year Ended	Benefit Payments	Administrative Expenses	Refunds	Total
6-30-99	$ 95,770,852	$ 858,663	$ 519,673	$ 97,149,188
6-30-00	107,375,100	742,134	90,109	108,207,343
6-30-01	120,422,501	699,869	647,619	121,769,989
6-30-02	130,781,444	748,180	388,974	131,918,598
6-30-03	134,409,191	737,200	356,839	135,503,230
6-30-04	137,238,098	717,952	579,783	138,535,833

SCHEDULE OF BENEFIT EXPENSES BY TYPE (UNAUDITED) — LAST SIX YEARS

	Age & Service Benefits		Survivor Benefits	Disability Benefits Retirants			Refunds		
Year Ended	Retirants	Benefi-ciaries	Death in Service	Duty	Non-Duty	Benefi-ciaries	Death	Sepa-ration	Total
6-30-99	$ 75,789,734	$ 11,446,489	$ 3,802,622	$ 1,163,350	$ 2,321,101	$ 1,247,556	$ 367,959	$ 151,714	$ 96,290,525
6-30-00	85,667,528	12,698,384	3,926,767	1,219,197	2,430,375	1,432,849	73,814	16,295	107,465,209
6-30-01	96,345,789	14,208,019	4,279,944	1,309,937	2,655,540	1,623,272	494,104	153,515	121,070,120
6-30-02	104,432,356	15,844,810	4,537,690	1,422,971	2,770,907	1,772,709	271,633	117,341	131,170,417
6-30-03	107,565,720	16,429,628	4,397,049	2,905,998	1,291,403	1,819,394	356,839	0	134,766,031
6-30-04	110,361,620	16,611,784	4,345,907	1,494,434	2,635,551	1,788,802	236,643	343,140	137,817,881

SCHEDULE OF RETIRED MEMBERS BY TYPE OF BENEFIT (UNAUDITED)

AS OF JUNE 30, 2004

Amount of Monthly Benefit	Number of Retirants	Type of Retirement*						
		1	2	3	4	5	6	7
DEFERRED	181							181
$1-250	124	109	10	1	1	3		
251-500	316	266	40	4	2	4		
501-750	328	242	66	2	3	7	8	
751-1,000	398	219	156		3	4	16	
1,001-1,250	274	178	51	13	6	16	10	
1,251-1,500	230	133	58	12	2	11	14	
1,501-1,750	273	182	52	8	13	8	10	
1,751-2,000	283	176	53	13	9	20	12	
2,001-2,250	302	212	45	8	13	16	8	
2,251-2,500	305	235	35	6	6	15	8	
2,501-2,750	353	292	33	9	3	9	7	
2,751-3,000	309	261	37	10	1			
3,001-3,250	288	240	33	9	1	4	1	
3,251-3,500	222	185	32	1		3	1	
3,501-3,750	199	178	18	2	1			
3,751-4,000	182	162	14	5		1		
4,001-4,250	132	108	18	5		1		
4,251-4,500	113	105	7			1		
4,501-4,750	71	65	5	1				
4,751-5,000	58	51	6	1				
5,001-UP	221	196	19	6				
Totals	5,162	3,795	788	116	64	123	95	181

Type of Retirement*

1 - Normal retirement for age & service
2 - Survivor payment-normal or early retirement
3 - Survivor payment-death in service
4 - Duty disability retirement
5 - Non-duty disability retirement
6 - Survivor payment-disability retirement
7 - Former member with deferred future benefit

(CONTUNUED)

Schedule of Retired Members by Type of Benefit (unaudited/continued)

As of June 30, 2004

Retirement Option Selected**									
A	B	C	D	E	F	G	H	I	J
44		14	8	8	4	36	10		
106	2	14	29	16	3	76	69	1	
92		44	54	9	6	72	50	1	
151	1	50	66	5	9	62	50	4	
85		35	60	8	5	42	38	1	
52	1	38	68	4	5	34	27	1	
69		47	62	12	13	43	26	1	
64		61	59	13	11	44	29	2	
60		96	44	19	17	40	24	2	
58	98	52	15	6	44	32			
69		125	54	20	17	37	28	3	
68		109	47	13	15	31	24	2	
38		112	44	18	16	29	25	6	
33	1	97	39	6	6	23	13	4	
30		80	34	7	8	26	11	2	1
28		62	34	2	11	24	13	7	1
16		65	29	2	3	6	8	3	
19	44	27	4		12	4	3		
13		24	15	1	5	5	4	3	1
10		12	20	4	2	5	2	3	
31		86	43	4	10	19	12	16	
1,136	147	1,250	828	177	222	690	466	62	3

Type of Retirement Option Selected**

A - Single Life
B - Option 1
C - Option 2
D - Option 3
E - Option 2 With a Bounce Back Provision
F - Option 3 With a Bounce Back Provision
G - Option 4 - 10 Year Certain
H - Option 4 - Death Benefit
I - Option 4 - Other Plan Selected
J - Option 4 - Other Plan Selected With a Bounce Back Provision

For a more complete description of the types of retirement options, refer to the "Notes to the Financial Statements"

SCHEDULE OF AVERAGE BENEFIT PAYMENTS (UNAUDITED) LAST SIX YEARS

	Years of Credited Service					
	5-10	10-15	15-20	20-25	25-30	30+
Number of Retirants						
6-30-99	415	549	680	844	1,062	1,400
6-30-00	428	533	650	826	1,154	1,435
6-30-01	442	513	610	802	1,227	1,449
6-30-02	449	491	580	772	1,284	1,445
6-30-03	483	466	563	724	1,513	1,211
6-30-04	487	450	542	702	1,556	1,244
Average Monthly Benefit						
Year Ended 6-30-99	$ 439	$ 657	$ 991	$ 1,354	$ 2,145	$ 2,625
Year Ended 6-30-00	476	720	1,097	1,495	2,365	2,902
Year Ended 6-30-01	515	797	1,229	1,664	2,593	3,197
Year Ended 6-30-02	542	848	1,326	1,780	2,724	3,360
Year Ended 6-30-03	563	896	1,329	1,845	2,754	3,519
Year Ended 6-30-04	561	917	1,364	1,886	2,795	3,576
Average Monthly Final Salary						
Year Ended 6-30-99	$ 0	$ 0	$ 4,806	$ 3,107	$ 4,046	$ 4,546
Year Ended 6-30-00	0	0	0	4,085	4,049	4,266
Year Ended 6-30-01	0	0	0	4,056	4,285	4,377
Year Ended 6-30-02	0	0	0	4,921	4,363	4,186
Year Ended 6-30-03	0	0	0	0	4,364	4,756
Year Ended 6-30-04	0	0	0	1,158	4,374	4,782

SCHEDULE OF PARTICIPATING EMPLOYERS, INCLUDING NUMBER OF ACTIVE MEMBERS AND AVERAGE ANNUAL SALARY (UNAUDITED)

LAST SIX YEARS

	June 30					
Participating Employers	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Number of Active Members						
City of Minneapolis	878	746	628	552	479	378
Minneapolis Special School District No. 1	410	345	289	248	200	151
Minnesota State Colleges & Univ.	2	1	1	1	1	1
Minneapolis-St. Paul Metropolitan Airports Commission	57	46	41	35	25	22
Metropolitan Council/ Environmental Services	2	1	0	0	0	0
Hennepin County	14	13	0	0	0	0
Total	1,363	1,152	959	836	705	552
Average Annual Salary	$ 47,003	$ 48,423	$ 48,319	$ 51,530	$ 52,045	$ 56,196