**Some Districts Face Big Decisions Regarding Post-Retirement Benefits**

By Charlie Kyte

A number of the school districts in the state of Minnesota have contracts with their employees that provide a certain level of benefits upon retirement. Most commonly, districts provide some allowance for health insurance benefits and in other cases there's an additional allowance for severance. Up to now, school districts paid these benefits annually as they occurred. That may still be the best option for many school districts.

New federal regulations have required school districts to come to terms with how much money is owed to their employees upon retirement. These studies have been phased in over the last few years depending on school district size. Prudent financial officers could then begin a process of setting aside money for these future benefits on an annual basis.

The 2008 Legislature passed legislation to give school districts two additional tools with which to work in handling their post-retirement obligations. One was to allow school districts to set up a trust fund and invest somewhat differently than the limited investments presently allowed for public money. Secondly, districts would be allowed to sell a bond to raise money for the post-retirement benefits and pay that bond off over time with a non-voter approved tax levy.

MASA has sponsored several workshops around the state in conjunction with financial firms to help school districts study and learn more about these particular options. We do advise that our members proceed cautiously as the new options are not an automatic cure-all and may cause some additional complications for school districts, even as they attempt to solve the post-retirement benefit problem.

**First**, let's discuss the idea of investing in a trust fund. Regular school district investments can only be invested in US government securities or in very secure private business financial investments. Typically, the return is about in line with a money market mutual fund. Today's return rate hovers around 1-2%.

With a trust fund, a school district could invest their money in a somewhat more aggressive set of investments, including stock equities and bond funds. Traditionally, these types of investments have shown a better return with earnings somewhere between 5-8% annually. This is the way pension system funds are invested.

However, one should not assume that the stock market and equities market only go up. As evidenced by the recent downturn in stocks, value can be lost as well as gained. The longer an entity is invested in equities, the better the chances for a positive return. It is important to remember that as you increase returns you also increase risk.

**Second**, let's discuss the issue of raising additional money to cover post-retirement benefits. The legislature has now authorized that bonds could be sold and that the bonds be paid back over time through tax levies. One consideration is to think about what a school district might do with the bond proceeds.

Ideally, the bond proceeds would be invested in trust fund investments and earn a return slightly higher than the cost of borrowing the money in the first place. This is dicey because the bond has a fixed rate, but the earnings from the trust fund may well be somewhat variable.

In addition, the difference between the investment rate and the borrowing rate needs to be significant enough to actually cover all or part of the school districts annual post-retirement obligations. When you put a pencil to this equation, you may find that the bond to be sold must be very large in order to produce this needed amount of income.

**Third**, there is the issue of the taxes that must be raised to pay off the bond obligation. Taxpayers, especially homeowners, will see an increase in their local property taxes which may cause political fallout for the school district. If the bond is quite small, the tax impact will also be quite small and may not be a cause of concern. However, a small amount of bonding may not provide the return needed. On the other hand, if the bond is very large there will be a significant consequence to the local property tax payers and they may well revolt.

We all recognize that school districts do need to go to their taxpayers from time to time either for building facility bonds or for operating levies. In either case, these moneys must be paid back by the local property tax payers. If a significant levy is added to the local school levies to pay for post-retirement benefits it may make it more difficult to convince voters to support other needed levies in the future.

**Fourth**, is the fact that many school districts, for the past decade, have slowly been weaning employee groups away from significant post-retirement benefits. They are instead substituting payments on an annual basis while employees are active. The most common way of doing this is to drop severance benefits and in turn add a matching contribution to 403(b)s each year that an employee actively works in the school district. This is a good trend, but could be reversed now that there is a way to pay for post-retirement benefits. We should reasonably expect that many union locals will come forth with proposals next year asking that their retirement benefits be increased.

**In conclusion**, there is an opportunity for school districts with significant post-retirement benefits to obtain some help. There are also significant challenges, both political and financial, that must be considered prior to using this approach to solve the problem. Careful study is needed as well as significant discussion with the school board and with community members prior to moving ahead.

We wish you good luck as you consider all the ramifications of utilizing the trust and bonding opportunities available to help solve the problem of post-retirement obligations.