Oregon PERS

Background, Changes Over Time, and Options for Cost Containment

Finance & Risk Management

January 29, 2013

Why Am I Here Today?

- Budget Note

  "The Chief Finance Officer will prepare a briefing and identify opportunities for the County to mitigate the impact of PERS rate increments on direct services and offer specific recommendations as to how to manage PERS liability. The briefing should include legislative changes, issuance of pension obligation bonds or other financing alternatives."

- Provide Background Information on PERS
  - What is PERS? How Are Benefits Determined?
  - Discuss Changes to PERS Over Time
- Multnomah County Response to PERS Rate Increases
  - Issuance of Pension Obligation Bonds (1999)
- Describe Potential Mitigation Strategies

PERS in the News

“OHSU looks to cut runaway PERS costs” (July 6, 2012)

“Unfunded liability of pension funds tightens it’s grip on Oregon” (July 18, 2012)

“Don’t let PERS make Oregon school year shorter, achievement gap worse” (August 8, 2012)

“How do we solve the PERS crisis?” (October 18, 2012)

“When even solutions are problems for the troubled pension system” (November 17, 2012)

Overview of PERS

- OR Public Employees Retirement System (PERS) is a cost sharing, multi-employer defined benefit pension plan
  - Administered by 5 member Board, appointed by Governor
  - Funds managed by Oregon Investment Council (OIC)
- Created by Legislature in 1945
  - County Has Been a Member Since 1971
- More Than 900 Participating Employers
  - Covers 95% of Public Service Workers in Oregon
  - Employers Grouped Into 4 Pools – County Belongs to State Local Government Rate Pool (SLGRP)

PERS Benefit Programs

PERS Maintains 3 Distinct Retirement Programs

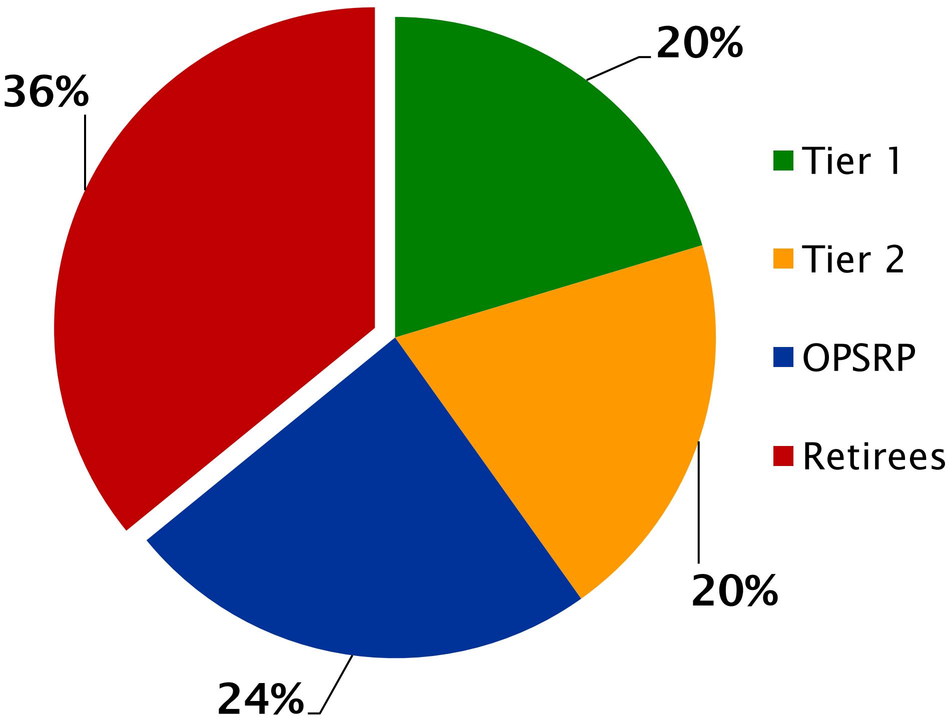
Tier 1 – Employees Hired Prior to 1/1/1996

Tier 2 – Employees Hired Between 1996 and 8/2003

OR Public Service Retirement Program (OPSRP) – Since 9/2003

Member Contributions Directed to Individual Account Program (IAP) After 1/2004

PERS Beneficiaries by Status
(Includes Members in Inactive Status)



PERS Benefit Comparison

	Tier 1	Tier 2	OPSRP
Normal Retirement Age			
General Service	58 (or 30 Years)	60 (or 30 Years)	65 (or 58 w/ 30 Years)
Uniformed (Police/Fire)	55 (or 50 w/ 25 Years)	55 (or 50 w/ 25 Years)	60 (or 53 w/ 25 Years)
Regular Account Earnings	Guaranteed 8% per Year	Market Returns	Market Returns
Variable Account Earnings	Market Returns	Market Returns	N/A
Retirement Calculation Methods	Money Match Full Formula	Money Match Full Formula	Full Formula Only
Full Formula Benefit Factor			
General Service	1.67% x Years of Service	1.67% x Years of Service	1.50% x Years of Service
Uniformed (Police/Fire)	2.00% x Years of Service	2.00% x Years of Service	1.80% x Years of Service
OR Income Tax Remedy	Yes	No	No

Benefit Calculation

- Earnings Credited to Member Accounts
  - Primarily Important for “Money Match” Option
- Multiple Payment Options for Tier 1/Tier 2
  - OPSRP Retirees Receive Fixed Monthly Payments
- COLA Applied Annually
  - Maximum is 2%, Cannot Be Less Than Zero
- Example (Using Full Formula Method)

  Final Average Salary = $60,000 ($5,000 per Month)

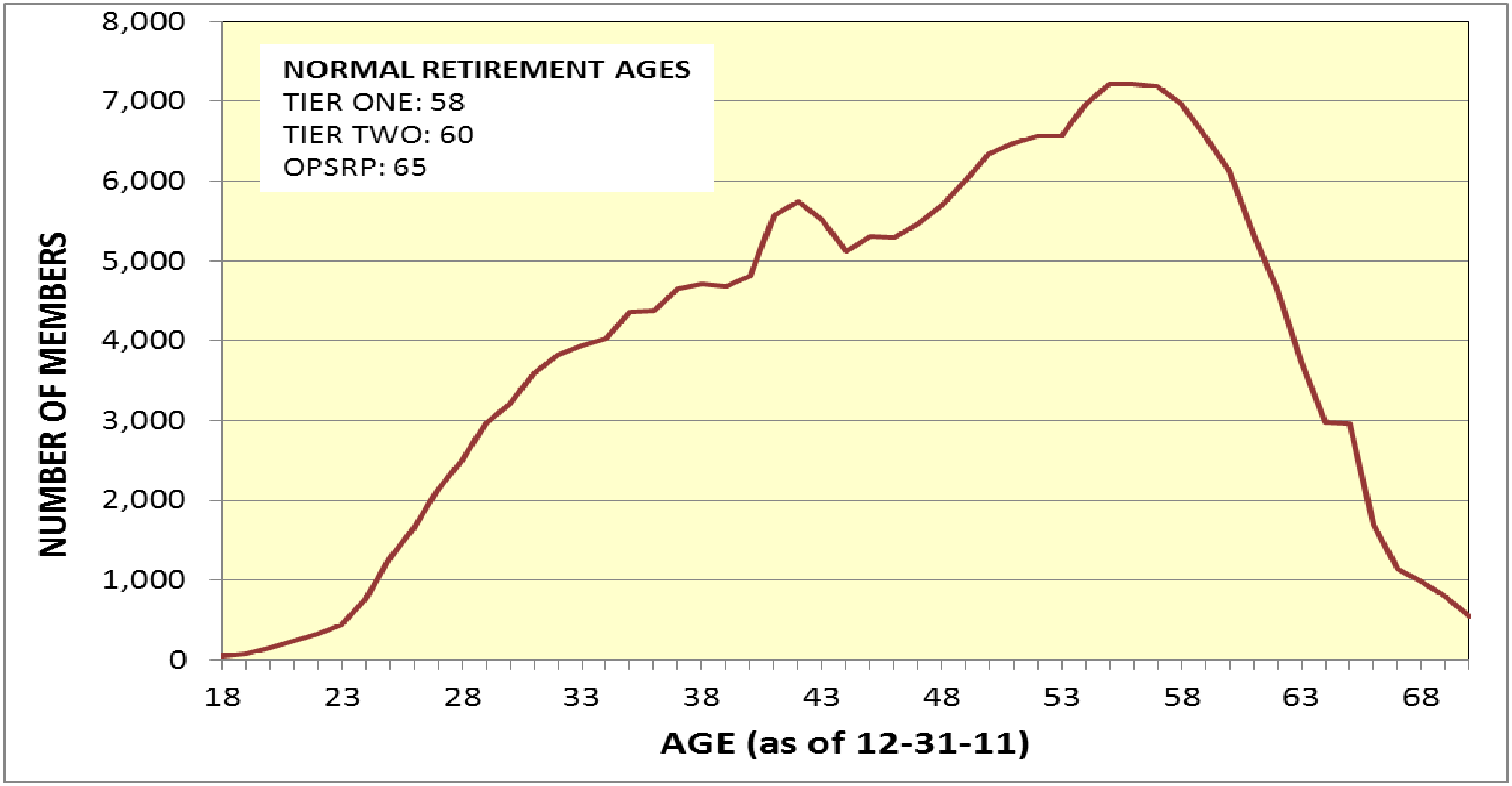
  Years of Service = 30 x 1.67 (Service Credit)

  Monthly Benefit = $2,505
- PERS Benefit Generally Designed to Provide 45% - 50% of Final Average Salary

2011 PERS Replacement Ratio Study

- Average Age at Retirement – 59
  - Average Years of Service - 22
- Average Final Salary at Retirement - $62,108
  - Average Monthly Retirement Benefit - $2,672 ($32,064)
  - Average Annual Retirement = 50% of Final Salary
- Retirees w/ 30 Years of Service
  - 10.35% Have 30 or More Years of Service
  - Average Monthly Retirement Benefit - $3,990 ($47,880)
  - Average Annual Retirement = 74% of Final Salary
  - 5.3% of Retirees Receive Annual Benefit > 100% of Final Salary

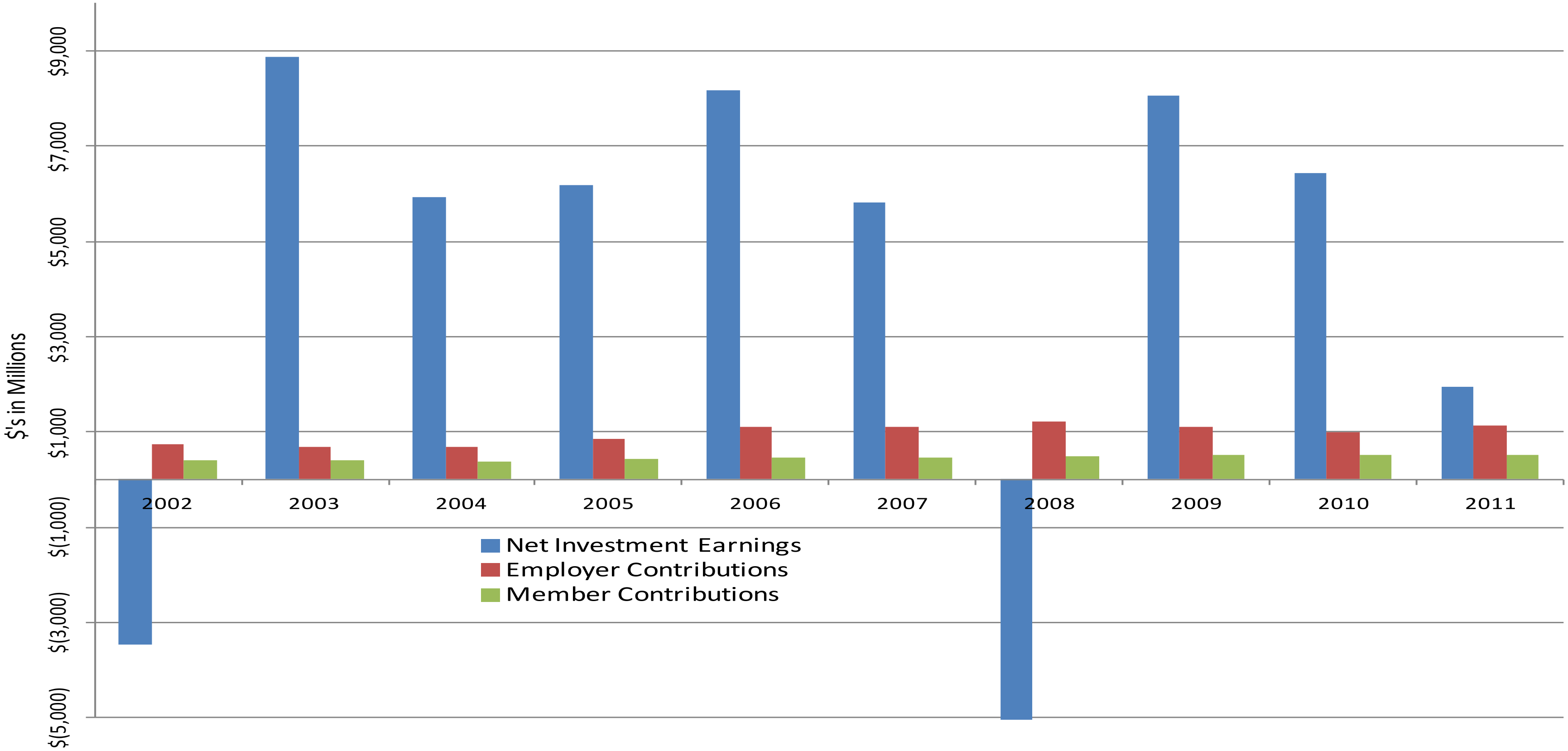
PERS Member Age Distribution



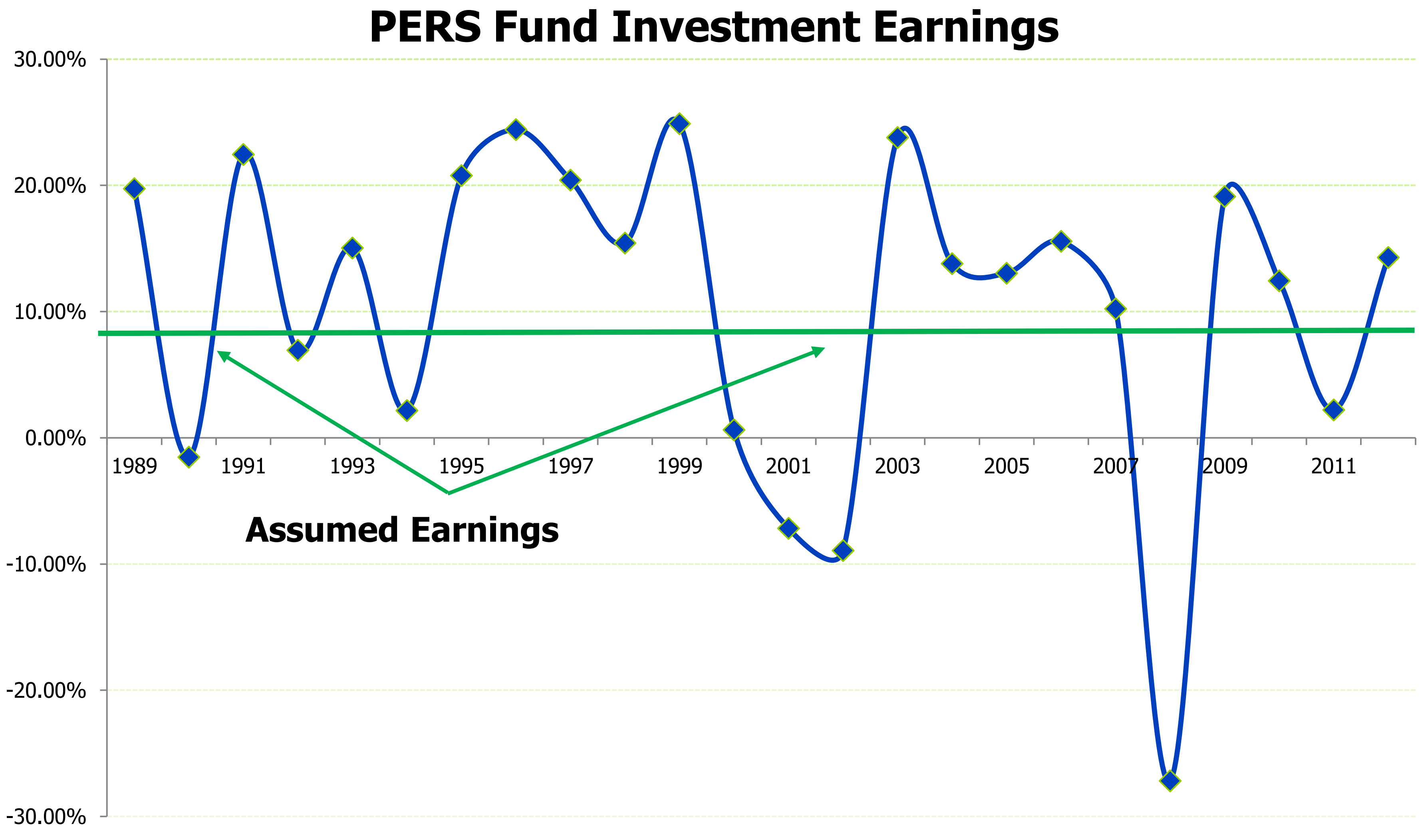
Note: Chart Includes All PERS Member Employers, Individual Employer Demographics May Vary

How Is PERS Funded?

- Investment Earnings
- Employer Contributions
- Member Contributions (Mostly Employer Paid via “Pick-Up”)



Investment Earnings



How Are Employer Rates Set?

- Actuarial Analysis – Provides Annual Valuation
  - Even Years – Advisory, Odd Years – Establish Rates
- Investment Earnings Dictate Employer Contributions
  - Assumed Rate of Return
- “Rate Collar” –Provide for Predictable Rate Changes
  - Up to 3% of Payroll if PERS Funded Between 80% and 120%
  - Up to 6% of Payroll if PERS Funded Below 80%
- Demographics and Presence of “Side Accounts” Will Impact Rate
  - Composition of Employee Groups
  - Age and Tenure of Employees
  - “Side Accounts” Credited to Employer Accounts

Impact on Multnomah County

	2005	2007	2009	2011
Allocated Pooled SLGRP T1/T2 UAL	$ 235,746,408	$ 12,008,083	$ 361,583,792	$ 437,382,026
Allocated Pre-SLGRP Pooled Liability/(Surplus)	(61,123,889)	(59,722,713)	(57,369,591)	(55,985,549)
Transition Liability/(Surplus)	(95,920,941)	(97,558,005)	(96,284,817)	(94,261,953)
Allocated Pooled OPSRP UAL	-	(2,287,628)	2,832,568	4,681,346
Net Unfuned Liability (UAL)	$ 78,701,578	$(147,560,263)	$ 210,761,952	$ 291,815,870
T1/T2 Net Employer Rate	11.05%	7.41%	11.85%	16.26%
Change From Previous Valuation	-1.80%	-3.64%	4.44%	4.41%

Notes:

The "T1/T2 Net Employer Rate" does not include 6% employer "pick-up" or cost of PERS Bonds issued in 1999.

Approximately half of the "T1/T2 Net Employer Rate" attributable to UAL.

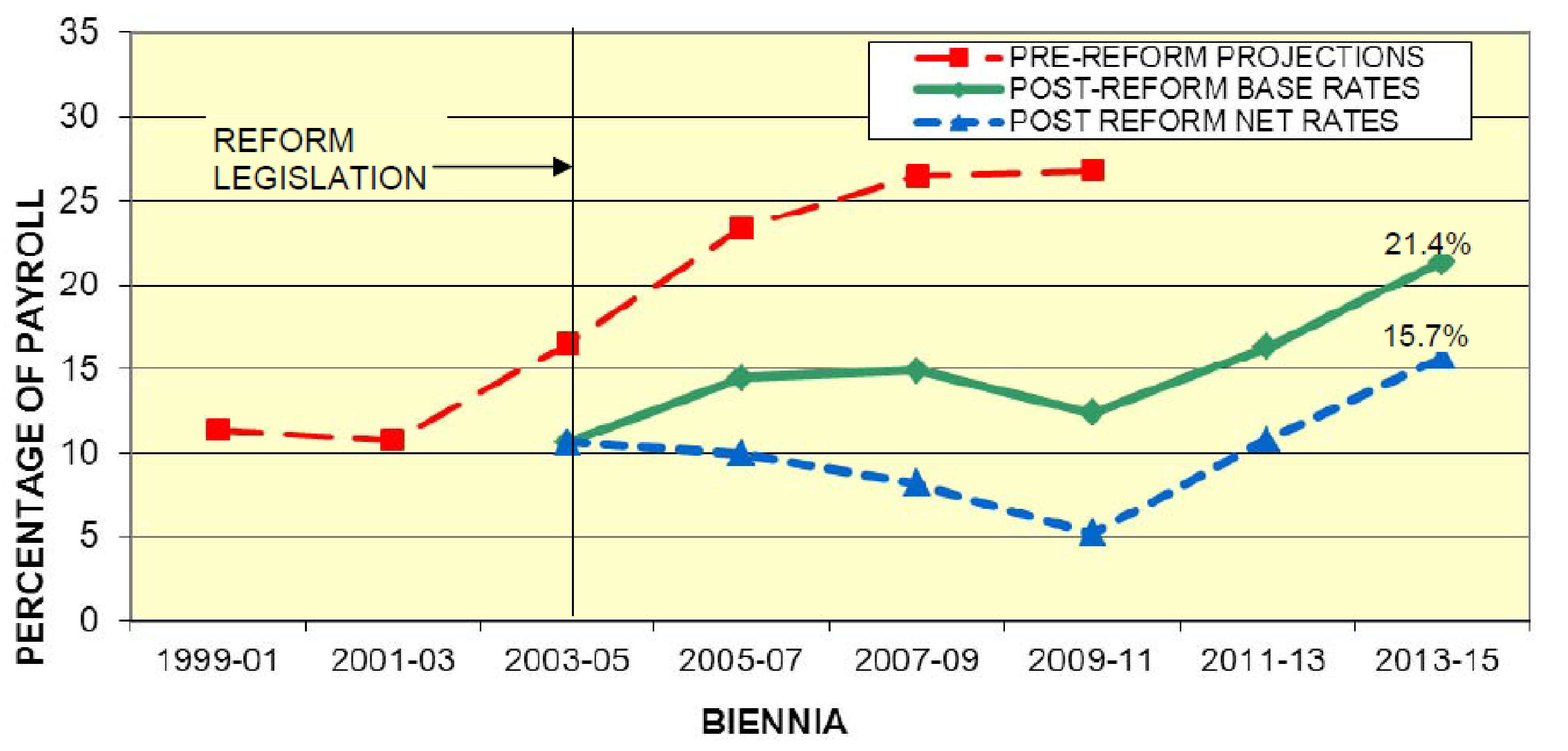
Some Thoughts About the UAL

- December, 2012 Valuation
  - PERS System Funded at 82% (Including "Side Accounts")
  - Total UAL = $14 Billion, Down From $17 Billion in 2008
- More Than 80% of UAL Attributable to Retirees and Tier 1 Employees
  - Most Accrued Prior to 2003 Reforms
  - Excess Crediting by PERS Board, Inadequate Reserves
  - Most Tier 1 Liability Associate w/ Employees Over 55
- Liability Growth
  - Approximately 12% per Year Prior to 2004
  - Average 3% - 4% Since 2003 Reforms Put in Place

2003 Legislative Reforms

- Initiated as a Result of “Dot-Com” Recession
- Multnomah County, Along w/ A Few Other Employers Took a Leadership Role
  - PERS Board Had Failed in Its Fiduciary Responsibility to Employers
- Major Changes
  - Limited Crediting for T1 Members to No More Than 8%
  - Shifted 6% “Pick-Up” to Individual Account Program (IAP)
  - Created Oregon Public Service Retirement System (OPSRP)
  - Updated Mortality Tables
  - Changed Composition of PERS Board
- Legislation Challenged in State and Federal Courts But Most Provisions Upheld

Impact of Reforms



- EXCLUDES 6% MEMBER CONTRIBUTIONS AND PENSION OBLIGATION BOND DEBT SERVICE PAYMENTS
- INCLUDES TIER ONE/TIER TWO AND OPSRP
- RATES FOR 2005-07 AND BEFORE ARE AS OF VALUATION DATE
- PRE-REFORM PROJECTIONS PREPARED APRIL 7, 2003 REFLECTING METHODS AND ASSUMPTIONS IN EFFECT AT THE TIME, INCLUDING AN ANNUAL 8% INVESTMENT RETURN

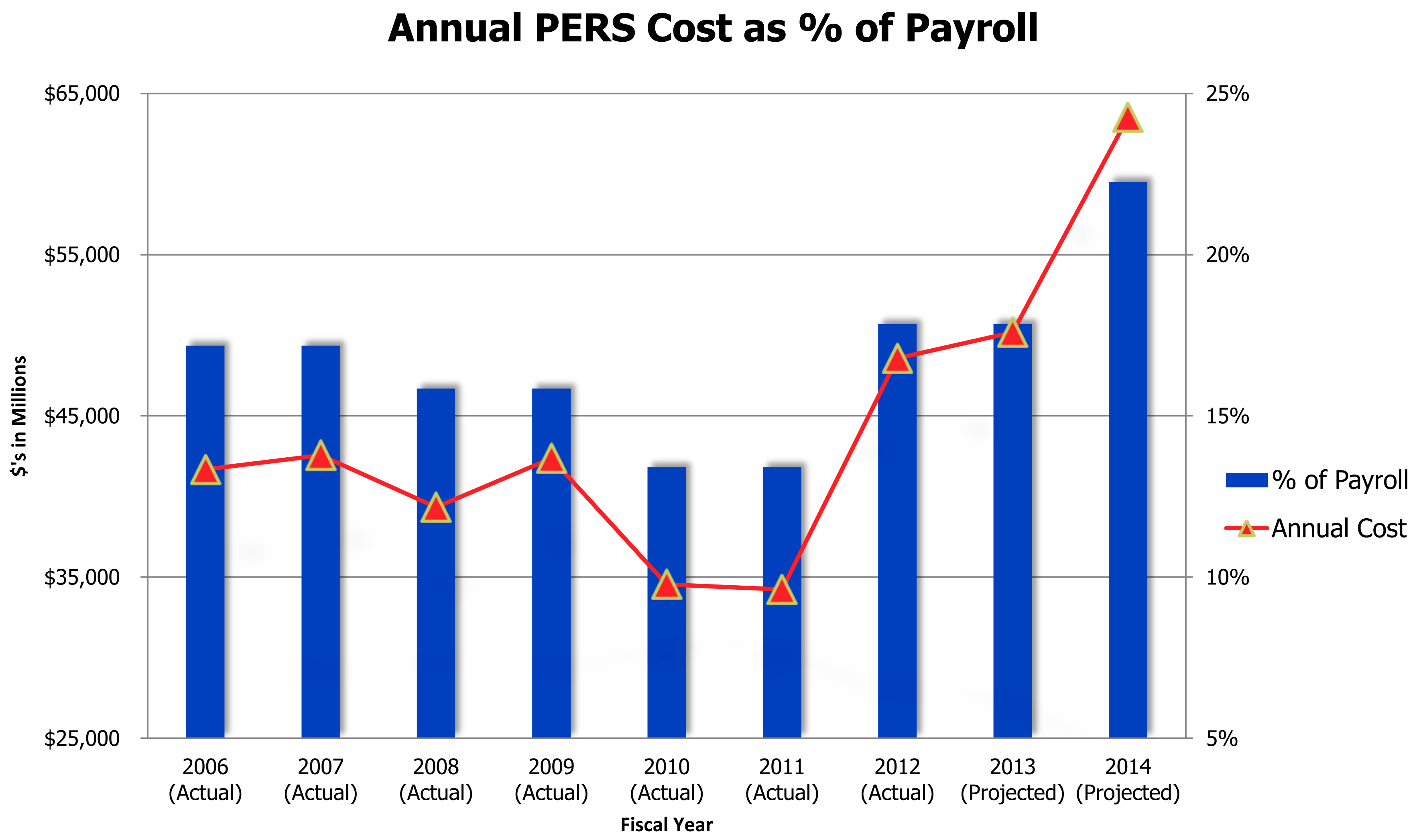
Current Situation

- Rate Relief Has Been Short Lived
  - "Great Recession" Highlighted Vulnerability of the System
- Limited Options for Addressing UAL
  - Courts Have Generally Upheld Prior PERS Commitments
- Average Rates Have Increased
  - About 4.5% of Payroll in Each of Last 2 Bienniums
  - Projections Indicate They Will Continue to Increase
- But, Multnomah County Better Off Than Most Employers
  - Issuance of Pension Obligation Bonds (1999)
  - Prudent Approach to PERS Rate Changes

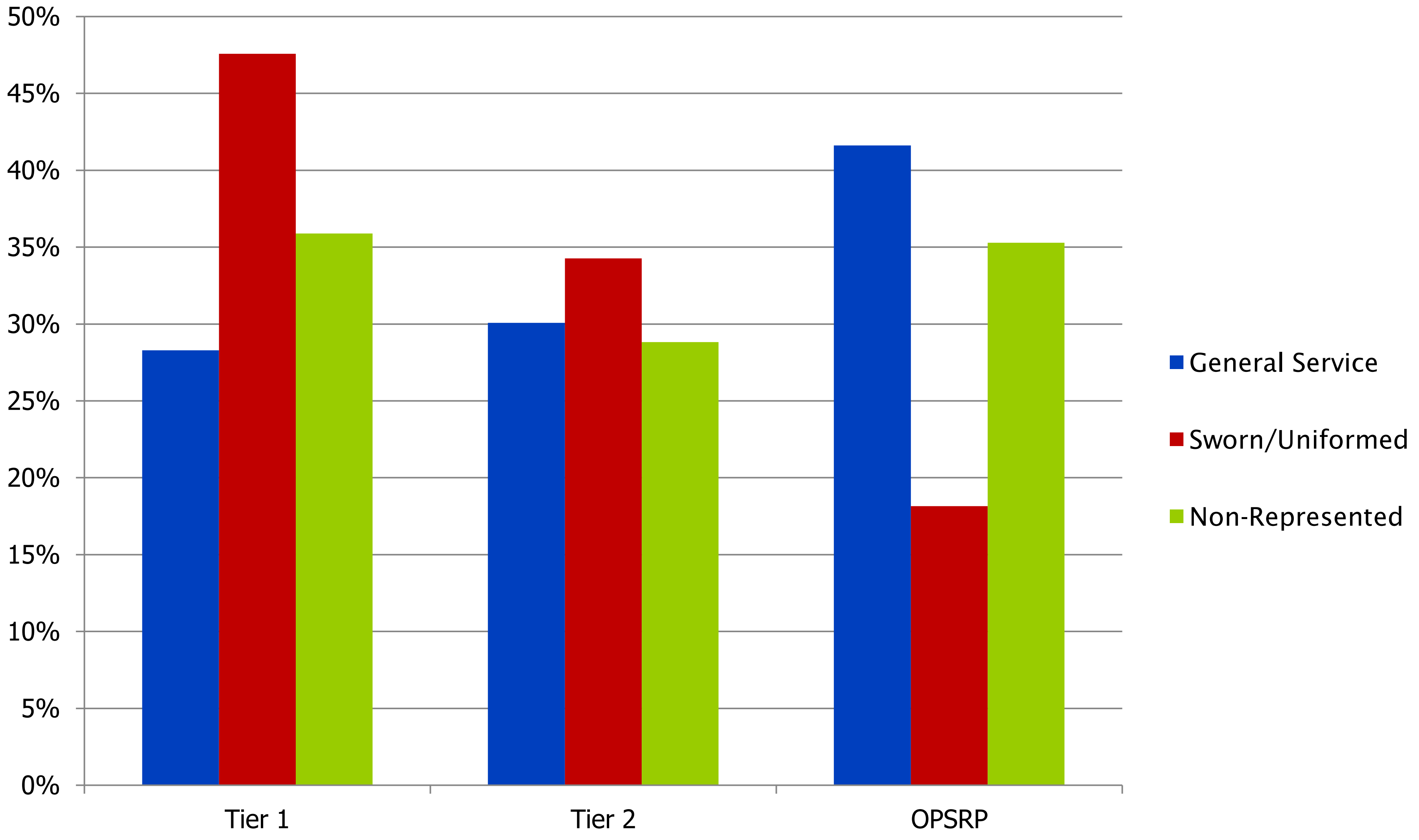
So, What Can We Do?

- PERS Changes Have Statewide Impact
  - Need to Balance Stability of System While Maintaining Fair Retirement Benefits
  - Limited Ability of Any One Employer to Influence Changes
- Create a "Side Account"
  - Issuance of Additional Pension Obligation Bonds
  - Lump Sum Transfer of OTO Funds to PERS
- PERS Employer Workgroup and PERS Board Concepts
- Governor's Budget Proposals
- Internal Management of PERS Liability

Multnomah County PERS Costs



Multnomah County Demographics



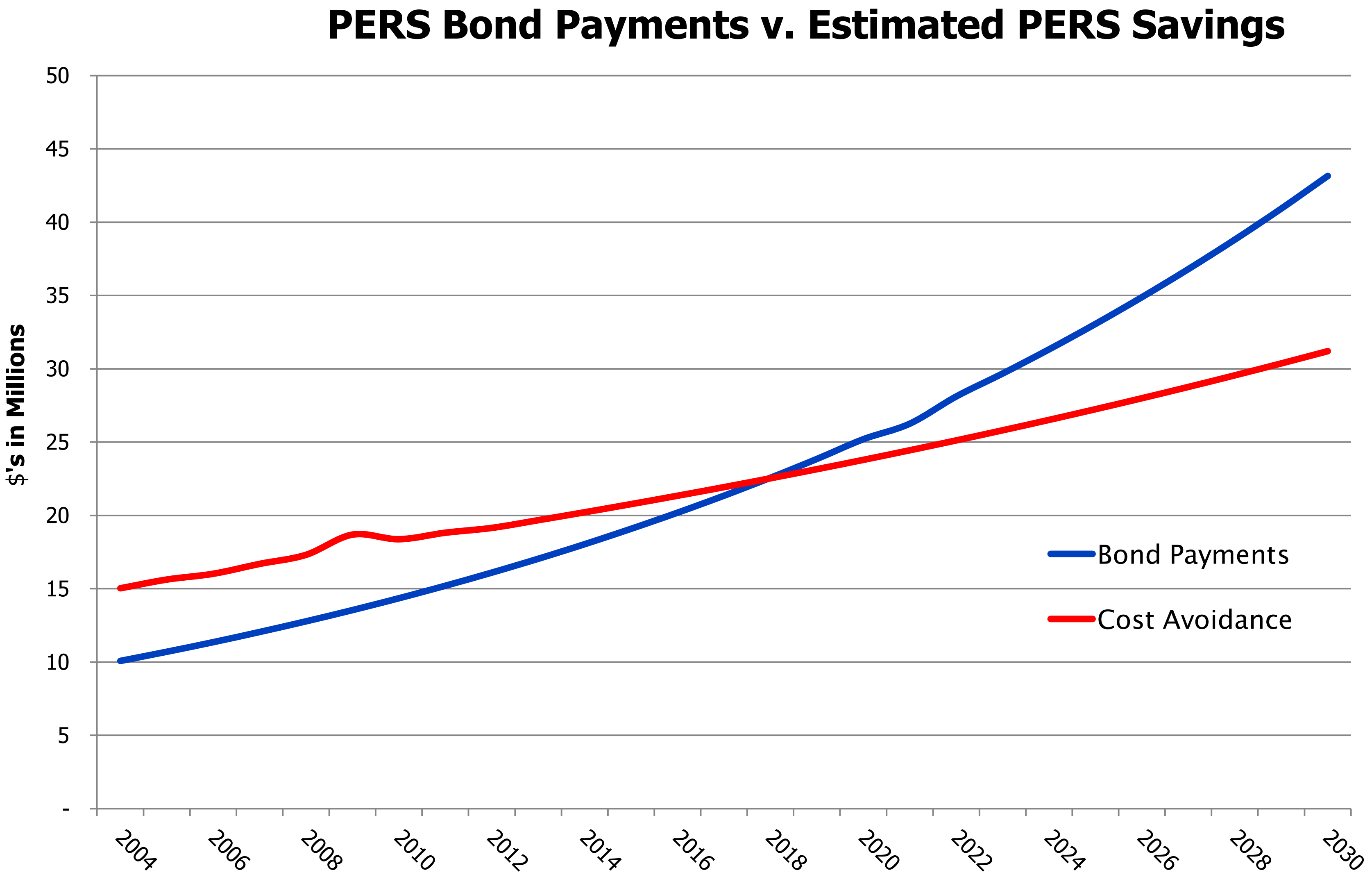
Potential Mitigation Strategies

- Bonding
  - Borrow at Historically Low Interest Rates and Invest Proceeds w/ PERS
  - PERS Fund Can Make Investments in Things That Local Governments Can't
  - If Rates of Return Exceed Cost of Borrowing There Are Savings
- County Issued $185 Million in 1999
  - Bonds Amortized Over 30 Years
  - Bonds Are Taxable
  - Payments Escalate on Average 5.5% Annually
  - Bonds Cannot Be Refinanced – Average Coupon = 7.5%

Bonding (Continued)

- How Does It Work?
  - Net Present Value Savings Estimated at $30 Million When Bonds Were Sold
  - Original Estimate Was Rates Would Be 3% -4% of Payroll Higher Without Bond Proceeds
  - Annual Debt Service Supported by a Surcharge on Payroll (Currently 6.5%)
  - But, Overall Rates Have Continued to Increase
- Conclusion
  - PERS Fund Losses in 2000’s Eroded Much of the Benefit of Bond Issuance
  - Because Payments Escalate Payroll Surcharge Will Need to Increase Over Time
  - Average PERS Fund Earnings 2000-2011 = 5.65%

Bonding (Continued)



Bonding (Continued)

- Should The County Issue Additional Bonds?
  - A Qualified Maybe
  - Taxable Interest Rates Much Lower Today Than 1999
  - Structure of Debt Issue Would Be Critical
  - Annual Debt Service on $300 Million = $18 Million
- Risk Analysis
  - When Combined w/ 1999 Bonds Outstanding PERS Debt Would be Approximately $430 Million
  - Total Payroll Surcharge Required = 13% of Payroll
  - Assumptions on PERS Fund Earnings Crucial to Analysis
    - Investment Returns Need to Meet or Exceed Long Term Averages
  - Bond Issuance Alone Will Not Solve the Problem
    - Will Need to be Paired With Other Mitigation Strategies

Concepts Related to COLAs

	203-15 Savings $'s in Millions	Employer Rate Decrease %
Limit COLA Eligibility to First $24,000 of Annual Benefits	$810	4.4%
Suspend COLA for One Biennium	$221	1.2%
Eliminate All COLA Increases (Current and Future)	$1,800	9.7%
Establish 10-Year Service Time for COLA	$55	0.3%

- Would Generally Reduce UAL by Reducing the Value of Future Benefits
- Impact Varies by Beneficiary Group But Most Directly Effects Retirees
- Approximately 54% of All Retired Members Currently Receive Annual Benefit of $24,000 or Less

Concepts Related to IAP

	203-15 Savings $'s in Millions	Employer Rate Decrease %
Eliminate Employer "Pick-Up" of 6% Member IAP	$129	0.7%
Allow Partial Employer "Pick-Up" of Member IAP	$74	0.4%
Eliminate 6% Member IAP Contribution Requirement	$129	0.7%
Re-direct 6% Member Contribution From IAP to PERS Fund	$570	3.1%

- Eliminating "Pick-Up" Not a Viable Option for County Due to "Pick-Up" Language in Labor Contracts
- Allowing for Partial Employer "Pick-Up" Would Require Negotiations with Labor Unions
- "Re-directing" Has an Overall Positive Impact on Employer Rates But Some Retirees Will Have Benefits Increased

Other Concepts from PERS Board

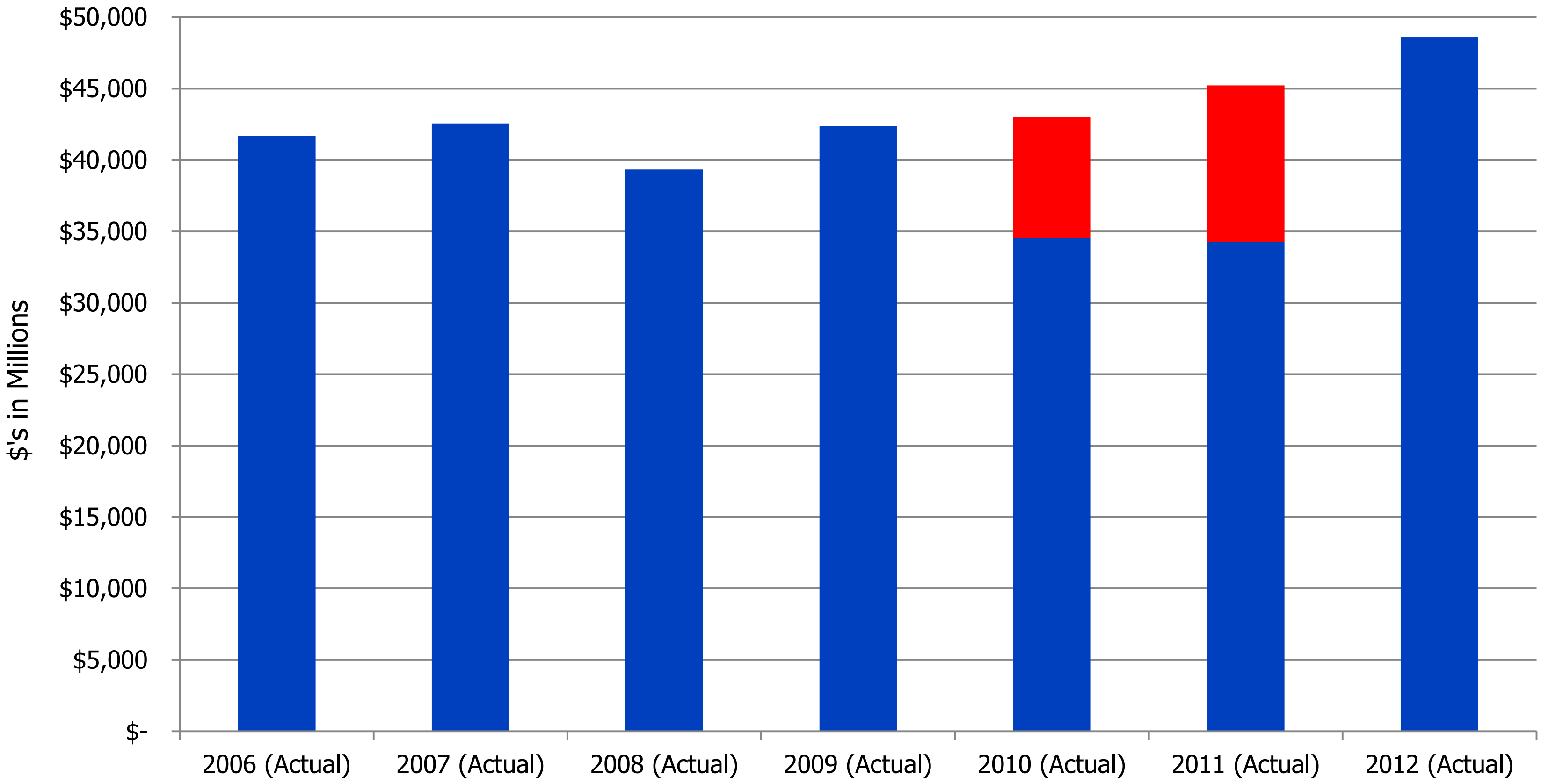
	203-15 Savings $'s in Millions	Employer Rate Decrease %
Reduce Money Match Annuity Rate to 6%	$147	0.8%
Eliminate Money Match Option for Tier 1/Tier 2	$442 - $497	2.4% - 2.7%
Eliminate "Tax Remedy" for Non-Oregon Residents	$55	0.3%
Remove Adjustment Factors for Final Average Salary	$129	0.7%

- Money Match Concepts Affect Tier 1/Tier 2 Only But Would Have Significant Impact on UAL ($6.1 billion)
- Supplemental "Tax Remedy" Benefit Paid to Members Who Began Service Prior to 1995, Would Effect About 15% of Retirees
- Eliminate Unused Vacation and Sick Leave From Final Average Salary Calculation

Concepts To Be Tested

- Governor's 2013 – 2015 Budget Proposal
  - Limit COLA to First $24,000 of Annual Benefit
  - Eliminate "Tax Remedy" for Out of State Retirees
  - If Actuarial Estimates Correct Would Eliminate Rate Increase Planned for 7/1/2013
- Reduce "Assumed Earnings Rate"
  - Currently at 8%, But Has Varied Over Time
  - Would Increase Employer Costs Over Short Term
- Extend Amortization of UAL to 25 – 30 Years
  - Lowers Employer Costs Over Short Term But Shifts Costs to Future Years
  - UAL Will Grow and Total Costs Will Be Higher
  - Impact on "Intergenerational Equity"

Internal Management of PERS Liability



- PERS Rates Reduced for 2009 – 2011, But County Kept at Same Level as 2007 - 2009
- $20 Million "Reserve" Held in PERS Bond Fund – To Be Used as a Lever to Mitigate Future Rate Increases

Final Thoughts

- Without Change Employer Rates Will Continue to Increase But Overall System Is In Good Shape
- Employer Rate Reductions Can Come From:
  - Reduction in Benefits Paid to Retirees
  - Extending Time Over Which Employer Costs Paid
- Employer Rate Increases Can Come From:
  - Increases in Benefits Paid to Retirees
  - Decrease in the Assumed Proportion of Benefits Paid by Investment Earnings
- Any Change to Member Benefits Will Likely Be Litigated
  - Last of Cases Challenging 2003 System Reforms Was Settled Just Two Months Ago

Suggested Reading

- *"Analysis of Cost Allocation, Benefit Modification, and System Financing Concepts for the 2013 Legislative Session"*
  - Prepared by PERS Actuary (January, 2013)

- *"PERS by the Numbers"*
  - Prepared by PERS Staff (December, 2012)

- *"Oregon PERS – Burdened by the Past, Poised for the Future"*
  - Prepared by City Club of Portland (May, 2011)