

Is This Really All About PERS?

Although Oregon faces both revenue instability and inadequacy, the state’s strategy to eliminate the PERS unfunded liability is *the* cost driver behind ongoing budget imbalances for public agencies – from schools to fire and water districts to parks and public safety departments – over the next 20 years.

Potential solutions at the scale of the problem include new dedicated revenue, changes to the payment schedule designed by the state, and innovations in public program delivery.

Further cuts to current workers’ pay packages will not significantly address the fiscal problem. Rebalancing total compensation packages to prepare for future market instability would shield both workers and the state from risk, but would not significantly reduce the near-term fiscal burden for public employers.

Oregon’s pension system is what many people think of when they talk about the state’s looming fiscal crisis. In the April 2018 article, “A \$76,000 Monthly Pension: Why States and Cities are Short on Cash,” *The New York Times* crystallized much current thinking about the relationship between the struggling local governments and Oregon’s partially funded pension reserve.

What the *New York Times* got right was focusing on a growing crisis affecting local government budgets in Oregon and around the nation. However, they oversimplified the cause of the challenges we face – and in so doing, obscured where we might find solutions.

PERS is really three things. These three components impact the monthly costs of the PERS system in different ways. Imprecise treatment of these elements results in frustration or misunderstanding for those looking for timely solutions at the scale of the problem.

It’s all called PERS. It’s not all broken.

1. Retiree Benefits	Cannot be changed
2. Normal Costs	Contributes little to the problem
3. Investment Fund	Strong performance
Payment Schedule	Employers Cannot Afford with Local Tax Limitations
Dedicated Funding	Needed, but politically difficult

1. PERS is the check that retirees receive now, fulfilling the promise made to them by employers and the state in the past. This promise is constitutionally protected.
2. PERS is the benefit offered to current workers today as part of their total pay package. These are called “normal costs.”
3. PERS is the investment fund that manages contributions from employers and employees to save for retirement. The performance of PERS investment accounts determines how much public employers need to contribute within a timeline that is set by state policy. The payment schedule determines how quickly the investment portfolio is funded. All contributions currently come from public employers.

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As of December 2017, the total pension commitment for Oregon was \$84B, and \$61.7B had been accrued through a combination of employer contributions and investment returns. This left an Unfunded Accrued Liability (UAL) of approximately \$22.3B (current estimates of the UAL hover around \$26.6B, though an official estimate will not be made until December 2019).

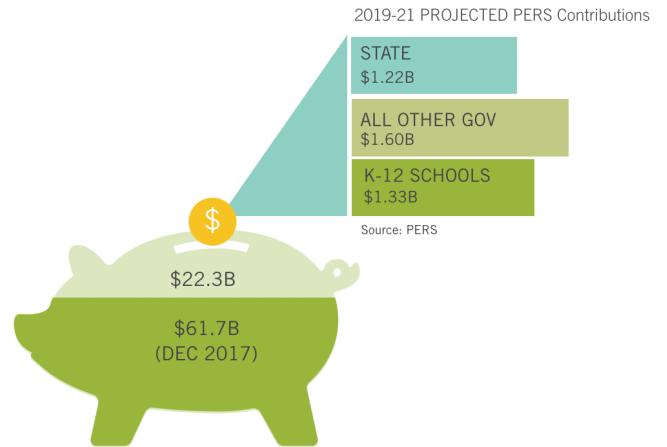
When most people think about reforming PERS, they think about changing the retirement benefits that Oregon offers to workers today. But the vast majority of the UAL represents a “legacy obligation” promised to people who have already retired, and linked to two benefit plans that are no longer offered to new hires. Six percent of the UAL is associated with the third tier OPSRP plan for current employees.

Legacy costs represent commitments that Oregon public employers and the state made to public employees decades ago, when expectations of economic growth and returns on PERS investments were much higher than they are now. Some of these commitments were beyond foolish - crediting employees’ accounts with 20 percent growth in years of unusual market performance without recognition of future market declines. Benefit packages of the past were much more generous. They have since been significantly reduced: In 1996, and again in 2003.

But other factors – largely outside of PERS administrators control – also played important roles in shifting the cost of legacy commitments onto today’s public budgets. The market crash during the Great Recession contributed over \$14B to the problem as PERS investments plummeted overnight, along with individual retirement and savings accounts across the nation. Furthermore, as health outcomes of Oregonians have improved and life expectancy has increased, it has become clear that the PERS fund was insufficient to pay retirement benefits for retirees who will live longer than actuaries had expected. This adjustment increased the UAL.

Currently, 65% of the PERS system’s projected costs through 2037 are directly tied to eliminating the UAL.

Public Employers Contribute to the PERS Fund



The stable, ongoing costs of providing retirement security to today’s public employees, and all future public employees for the next couple of decades, represent only 35% of the projected PERS costs in that timeframe. This means that if the PERS program were halted tomorrow, and all public employers stopped offering retirement plans to their employees, they would still have an enormous financial mountain to climb.

Oregon is legally and ethically bound to honor legacy commitments. Innovative solutions to keep these promises, while mitigating the fiscal distress to governments and communities resulting from the UAL funding plan merit further exploration.

One challenge is that Oregon’s track record as an investor is strong; we cannot count on stronger performance in the stock market. Today, about 75 cents of every dollar in the PERS fund is the result of investment returns.

This limits the tools that can be used to address how PERS liabilities impact local governments budget, and their ability to provide public services and manage public resources. Within the framework of the PERS system itself, those tools include **dedicated funding** outside of employer contributions and **adjusting the timeline** over which payments must be made.

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Outside the framework of the PERS system, solutions could include **program delivery innovations** (such as automating functions or consolidating redundant systems); Creation of New Deal-style **jobs programs** or a broader state **public retirement program** (either of which would increase the OPSRP pool and could increase total funded status as a result); or increased **revenue for public services** – such as the 2019 Student Success Act – a large portion of which would fund past PERS obligations.

Visualizing the Current Payment Plan

The graph below illustrates PERS costs over the next twenty years (excluding side accounts and pension obligation bonds). The white bars show the projected annual size of the UAL on the current timeline, which is determined by state policy. On this timeline, the

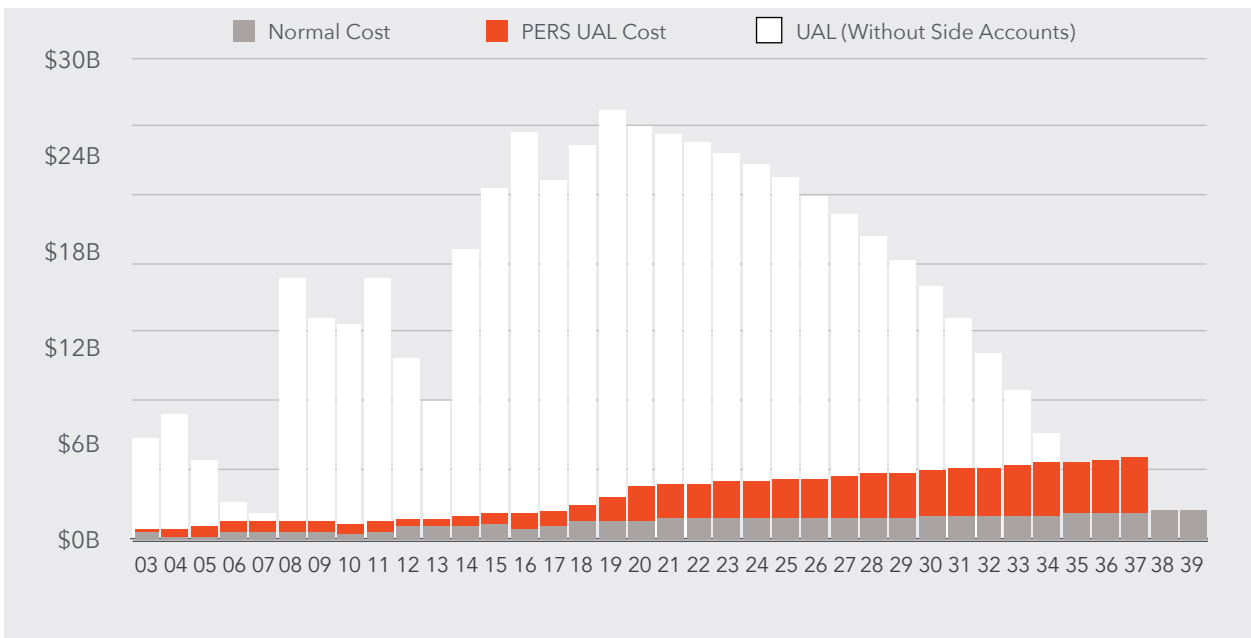
UAL decreases as employers make larger and larger payments to fully fund PERS investment accounts.

Employer’s payments are show in the gray and red bars. The gray bars represent the “normal” costs of the system - the costs of current workers’ benefits earned going forward. We estimate these costs to increase by 3.5% each year.

The red bars represent the additional costs that public employers will pay each year to cover retirement benefits promised in the past (i.e. the costs to fully fund the UAL). These costs must be paid, but the schedule for paying them is a policy question; the graph demonstrates the current schedule. If this schedule is kept, the UAL is projected to be fully funded in the 2035-2037 biennium, after which PERS contributions should equal the system’s normal costs.

Oregon PERS UAL and Employer Costs

Oregon’s pension system holds primary assets of about \$61.7B. The system carries a total unfunded liability (UAL) of about \$26.6B. This balance of assets to obligations makes Oregon PERS the 12th best funded system in the country. However, the plan to fund the \$26.6B UAL will require contributions from public employers from 2019-2037 that will seriously impact the ability of schools, cities, counties and special jurisdictions to serve Oregon communities. The chart below shows how “Normal Costs” for current employees (dark grey) compare with the payment plan to fully fund the UAL (red).



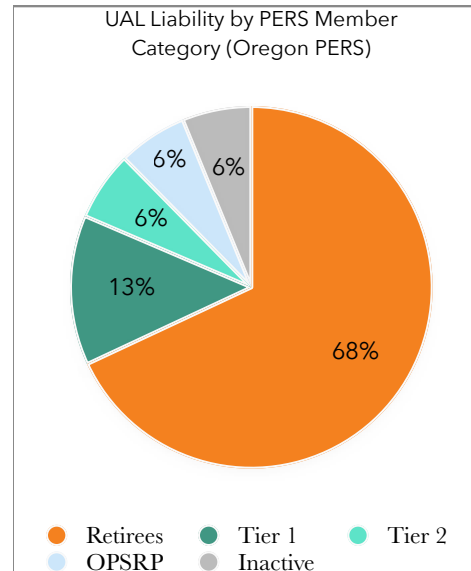
PERS System Primer

A Brief Overview of PERS System

The Oregon Public Employees Retirement System (PERS) provides retirees who have spent their careers in public service with a monthly retirement stipend. PERS began in 1945 with the idea that public employers could make annual contributions to a dedicated investment account, that would grow with the market and then be drawn on to pay retirement benefits to employees after they retired. Since this system began, it has undergone significant changes: the size and quality of retirement benefits has fluctuated over time, as has the performance of PERS investment accounts.

PERS Benefits: *the retirement security offered to public employees as part of their overall compensation package.* These payments to retirees come from a dedicated fund, managed by the State of Oregon Treasury and backed by bonds. PERS currently has three benefit pools (or “tiers”) extended to employees based on when they were hired. Tier 1, which offers the most generous benefits, covers public employees hired before 1996; Tier 2 covers public employees hired between 1996 and 2003; and OPSRP covers public employees hired after 2003. 66% of current employees are in the OPSRP benefit pool. The median benefit paid to retirees across all pools is currently about \$2,058 per month, or about \$24,700 annually.

PERS Unfunded Actuarial Liability (UAL): *the difference between the amount of money necessary in the PERS fund to meet benefit commitments to current and future retirees and what is actually in the fund.* For example in 2017, PERS estimated it held a total of \$84.0B in liabilities— meaning that \$84.0B was the amount the fund needed in order to generate enough returns (based on assumptions about future return rates) to pay all of the benefits that public employees and retirees had accrued to date. However, the PERS fund only held \$61.7B in



assets, indicating that \$22.3B of those liabilities were “unfunded.” The system as a whole was “underfunded.”

PERS became underfunded for a variety of reasons: poor investment performance during the Great Recession, changes in the projected rate of future investment returns, and longer life expectancies as health outcomes of Oregonians improved, to name only a few.

As of early 2019, the UAL has grown to approximately \$26.6B. Only 6% of that is associated with the OPSRP plan for current employees. Therefore, the vast majority of the UAL is a “legacy obligation” related to the older Tier 1 and Tier 2 benefit plans, which are no longer available to new hires. Oregon’s current strategy for fully funding the PERS liability is to increase public employer contributions.

PERS Employer Contributions: *the annual amount employers put into the PERS fund to provide retirement security for their current and prior employees.* If PERS were fully funded, employer contributions would equal the cost of providing retirement benefits only to current employees.

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These “normal costs” of the system are decreasing as Tier 1 and Tier 2 employees retire, and a growing share of public employees are covered by OPSRP. However, because PERS is underfunded, employers must pay an additional amount above the “normal” costs of the system. Oregon’s plan to fully fund the UAL requires increases in employer contributions over the next 20 years. In 2017-18, public employer rate increases exceeded property tax revenue growth rates for the vast majority of jurisdictions. These rate increases represented 4-5 percentage points of payroll for most local governments.

PERS Employer Contribution Rates: *The size of PERS employer contributions are often described as rates of payroll.* For example, a 20% contribution rate indicates that an employer pays 20% of payroll towards the PERS system.

Side Accounts and Pension Obligation Bonds: *side accounts represent single, one-time payments that public employers can make towards the PERS system.* These “side accounts” are invested in the market and drawn on over a number of years to help offset a portion of an employer’s contribution each year. In the past couple of decades, some employers have chosen to sell “pension obligation bonds” in order to fund side accounts, hoping that the return on the investment of their side account is higher than the interest they will pay on their pension obligation bonds. Debt service on pension obligation bonds is an additional cost to public employers, separate from employers’ annual contributions to PERS.