Joint Ways and Means Subcommittee on Capital Construction
March 29, 2019
Testimony of Tim Nesbitt, Interim Executive Director, PERS Solutions for Public Services

My name is Tim Nesbitt, representing PERS Solutions for Public Services.

Thank you for this opportunity to offer our ideas for how to stem the rising costs of the Public Employees Retirement System (PERS) and to limit the toll those costs will otherwise take on public services for decades to come.

I'm going to start with a few numbers, but I want to move quickly to the real world impacts of these numbers on all of us as Oregonians and spend most of my time on solutions.

I'll start with the numbers on the data sheets and charts I have shared with you. At times, you'll hear conflicting claims about the size of the PERS "unfunded actuarial liability" or UAL. That UAL was $26.6 billion as of last December 31, up from $23.3 billion the year before. Or maybe it's only $19 billion, when you count employer side accounts. What about side accounts?

Side accounts are pre-payment accounts. But they were not created out of thin air. In most cases they were financed with borrowed funds, via pension obligation bonds, and the debt service on those bonds is still being paid by their sponsors. So, PERS liabilities and their effects on budgets are a tale of two credit cards. To show the cost of one and not the other doesn't tell the whole story.

Our data capture the ongoing costs of paying for benefits as they're earned and projected costs for paying off both credit cards. This is how we computed the actual cost increases that PERS employers will experience over the next several biennia, when PERS payroll rates are projected to increase by more than 50% -- on top of the doubling that we experienced this decade. We used the payroll cost projection tools that PERS itself developed for its employers and the pension obligation bond payments compiled by the Treasurer's Office.

The assumptions we used are neither worst case nor best case. They capture the most likely results if our economy remains strong, investment returns recover from last year's subpar performance and manage to meet expectations in the years ahead. If anything, our assumptions are optimistic.

But the numbers that result from these assumptions are sobering. Public jurisdictions and their taxpayers will be required to pay an additional $10 billion to PERS and to pension obligation bondholders over the next eight years above what they are already paying in current budgets. PERS costs will reach, exceed and stay above 30% of payroll during the next two decades, compared to the 12% average borne by employers during the four decades preceding this biennium.

But this is about more than just numbers. Just as the revenue raising targets you have in your sights are about more than just numbers.

This is about kids in our classrooms, including the class of 2025, now starting middle school, and those who come after them, to whom you have committed your best efforts to achieve a 100% high school graduation rate and to create better paths forward to college and careers.

With no change in the path we're on, our K12 school districts will be diverting an additional $650 million per year from their classrooms to the PERS fund by 2025 – an amount of funding that would otherwise support 5,500 teachers or 22 days of school in a year.

All of these numbers in all of our public jurisdictions have sympathetic faces – of pre-schoolers, students, working families and seniors. And compelling stories – of child care workers, teachers, care givers and first responders. But that won't exempt any of them or us from the real world effects of the numbers we're faced with.

For public workers, in particular, this is not about fault. But it has to be about solutions. Just as in bargaining.

Imagine if PERS were bargained and not legislated. We'd be talking about the rising cost of a benefit that will squeeze resources for raises, for health benefits, for staffing and for the supplies and equipment you need to do your best on the job. This is not about cutting a benefit to strip money out of budgets. But rebalancing where needed to be able to do better as our economy and our resources continue to grow.

But PERS is legislated, and you're the legislators.

So let's start with the reckoning that mistakes were made which have yet to be corrected. And let's recognize that the Supreme Court charted a new path forward with its *Moro* decision in 2015, when the justices affirmed the legality of correcting mistakes on a going forward basis.

What mistakes need correcting? Here are a few examples.

The Money Match formula for Tier 1 and 2 and the guaranteed rate of return for Tier 1 accounts have produced payouts far above the PERS goal for an adequate benefit for nearly half of all retirees since the early 1990s. Those features created today's legacy costs, and they continue to drive up future costs for those in the current workforce hired before 2003.

Then there's the irony of the 2003 reforms. Those reforms worked to stanch the growth of Money Match accounts, but they created a new problem by shifting 100% of the system's pension costs to employers. And they added more costs and benefits to the system by redirecting employee contributions to a supplemental retirement savings plan.

With these changes, employer pickups of those 6% employee contributions became more controversial. But the pickup is not the problem, at least not when it's paid in lieu of salary. The issue is that the 6% -- whether paid by employees or paid by their employers – no longer supports the pension plan. Now it buys more retirement benefits.

That change made sense at the time and for a few years thereafter, but it has added to the costs of the system over time. And, now, in the wake of the *Moro* decision, it is no longer the only way to cap those Money Match accounts. Instead, you can simply direct employee contributions to support the years-of-service pension formula and not the Money Match mechanism.

Nor is there any legal or fiscal or practical reason to allow Tier 1 and 2 retirees to be re-employed while collecting full retirement benefits and letting their employers forego pension payments that would otherwise have to be paid on those positions. As this program works now, legacy costs are shifted from older, better-benefited retirees to younger, lesser-benefited employees whenever these re-employments occur.

But all of these mistakes, when corrected, become solutions.

- Correct the excesses of the Money Match program going forward and save $75 million in the next biennium.
- Require employer and employee contributions to the system when re-employing retirees and reduce the system's unfunded liability by $100 million in the next biennium.
- Reinstate employee contributions of 6% to the pension plan and modify the cost sharing structure so that those hired after 2003 pay 3% and those with the richer benefits pay 6% for their pensions – and save $900 million in the next biennium. And no employees in either bracket would suffer any reduction of their paychecks.

Another unexpected result of the 2003 changes is that they created a kind of marketing trial for a defined contribution plan. The supplemental retirement savings plan created then is the equivalent of a 401(k)-style plan. OHSU took that plan, doubled it to 12% and now offers it to new hires as an alternative to the PERS pension plan. 95% of new hires choose or default into the 401(k)-style plan, saving OHSU about two and a half points of payroll for each enrollee.

More than half of the public employees we consulted in focus groups last year told us they'd like to have the choice of a better-funded 401(k)-style plan as an alternative to the traditional pension plan. Their preferences varied by occupation and career goals. But creating retirement plan choices for employees was the single most popular reform embraced in those groups.

We've outlined these and other cost-saving reforms in the handout I've submitted to you and on our website at www.PERSsolutions.org.

We call these sensible solutions. We believe they are necessary solutions. But they are perceived by some as part of a corporate agenda or as an attack on public employees and their unions.

To the contrary. The most significant cost-saving reform on our list, namely the reinstatement of employee cost sharing in the PERS pension plan, was first advanced by Gov. Kulongoski's Reset Cabinet in 2010 and then refined and adopted as a recommendation by the Portland City Club in 2011.

And, as someone who worked for 27 years in the union movement, I hear regularly from former colleagues in the private sector about adjustments made in their own pension plans in order to keep benefits sustainable for those who will come after them.

And I hear often from former colleagues in the public sector that they never expected their PERS benefits to be as lucrative as they turned out to be and that, confidentially, they know something has to be done.

Further, as a PERS retiree myself, I can attest that my five years of coverage in the third tier of the PERS pension plan were far better for me than the retirement benefits I earned during any equivalent period in working for unions.

Yes, the proposals we submit for your consideration will affect current employees. But nowhere near as drastically as some are alleging. Nowhere in our proposals are we trying to shift costs from retirees to active employees. And nowhere do we recommend reducing the years-of-service benefit formula in any of the PERS pension plans.

Further, our proposals have been designed to address issues of equity in the public workforce and to appeal to a new generation of public employees.

And here's another caveat: Employees enrolled in the Police and Fire system deserve different consideration. Their shorter careers made them less likely to benefit from the Money Match option in the past and make them less likely to do better in a 401(k)-style retirement plan in the future.

Considerations of equity and an honest engagement of facts and findings like these can help get us through a process that promises no perfect or complete solutions.

No perfect solutions, because legacy costs are inherently unfair, shifting costs from one generation to the next.

No complete solutions, because even with the reforms we propose, we'll be left with a big debt to work down over the course of decades to come.

With no course correction, PERS will force changes affecting all current and future employees – squeezing budgets to leave less funds for raises, health benefits, staffing and the ability to do their jobs and accomplish their mission as public employees.

But, if we correct what is correctable going forward and ensure that costs do not continue to rise as they have throughout this decade, we can work to chart a better way forward...without kicking the can down the road...and without kicking to the side of the road a whole generation of Oregonians whose educations will otherwise be compromised and whose social services will be stretched to the breaking point.

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PERS SOLUTIONS
FOR PUBLIC SERVICES

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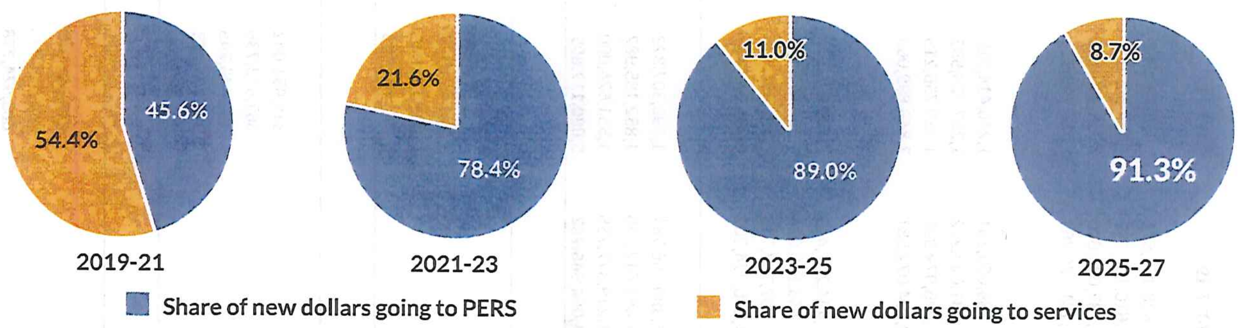
PROBLEM

PERS cost increases will claim an additional $10 billion from public service budgets over the next eight years. Even with a $2 billion revenue package dedicated to education and state services, **80 cents of every new dollar will go to PERS** in that eight year period.

$2 Billion Revenue vs PERS Costs through 2027 (millions of $)

	$2 Billion Rev. +5%/year	Cumulative PERS Cost Increases All Entities	Biennial Percentage PERS/Revenue	Cumulative PERS Cost Increases State/Education	Biennial Percentage PERS/Revenue
2019-21	$1,500*	$1,015	67.7%	$684	45.6%
2021-23	$2,205	$2,546	115.5%	$1,728	78.4%
2023-25	$2,431	$3,109	127.9%	$2,163	89.0%
2025-27	$2,680	$3,496	130.4%	$2,448	91.3%
Total 2019-27	$8,816	$10,166	115.3%	$7,023	79.7%

*18 months



SOLUTIONS

PROPOSAL	RELATED LEGISLATION	INITIAL 2019-21 EMPLOYER COST REDUCTIONS	LONG TERM COST/UAL REDUCTIONS	WOULD FREE UP FUNDING IN 2019-21 K12 BUDGETS FOR:
Reinstate Employee Cost Sharing *for the PERS pension plan @6% for all or 6% Tier 1/2 & 3% OPSRP*	SB 148 SB 531 SB 533	$1,300 million at 6% $930 million at 6%/3%	N/A	 1,500 teachers or 6 days of school
Modify Tier 1/2 Benefits *related to Money Match annuitization*	None	~$75 million*	~$800 million over 20 years*	125 teachers
Establish New Defined Contribution Plan *at 12% or expand IAP to 12% as alternative to pension plan*	SB 641	OHSU model would save ~2.5% per participant	N/A	For each 1% of workforce participation: 9 teachers
Reform "Double Dipping" Practice with *"Work Back/Pay Back" plan*	SB 149	N/A	~$500 million over 8 years (UAL)	N/A

*October 2016 Milliman estimate for 2017-19.

PERS Costs versus New Revenue of $2 Billion/Biennium

OBC Analysis of PERS Projection Tool Output	**2017-19**	**2019-21**	**2021-23**	**2023-25**	**2025-27**	**2027-29**
Payroll						
State agencies, Public Universities and Community Colleges	6,828,155,571	7,314,490,951	7,835,465,569	8,393,546,604	8,991,376,961	9,631,787,785
School Districts and ESDs	6,616,131,152	7,087,365,094	7,592,162,673	8,132,914,459	8,712,181,291	9,332,706,404
Local Governments	6,737,090,040	7,216,939,278	7,730,965,778	8,281,603,816	8,871,461,048	9,503,330,861
Total (systemwide)	20,181,376,763	21,618,795,323	23,158,594,020	24,808,064,879	26,575,019,300	28,467,825,050
Net PERS Contributions						
State agencies, Public Universities and Community Colleges	936,069,361	1,216,414,316	1,697,943,733	1,860,337,055	1,936,187,175	1,989,169,177
School Districts and ESDs	931,023,222	1,267,728,532	1,745,194,676	1,914,480,602	2,000,541,072	2,065,367,036
Local Governments	1,026,979,998	1,359,756,215	1,845,672,464	2,018,573,128	2,105,637,355	2,169,318,028
Total (systemwide)	2,894,072,581	3,843,899,063	5,288,810,873	5,793,390,786	6,042,365,603	6,223,854,241
Debt Service						
State agencies, Public Universities and Community Colleges	444,287,419	479,893,507	518,479,607	571,009,013	622,448,512	181,500,113
School Districts and ESDs	533,589,024	564,457,450	611,330,831	661,726,977	733,884,673	382,152,550
Local Governments	192,397,758	191,867,786	192,388,688	147,313,418	162,454,929	102,758,768
Total (systemwide)	1,170,274,201	1,236,218,743	1,322,199,126	1,380,049,408	1,518,788,114	666,411,431
Net PERS Contributions + Debt Service						
State agencies, Public Universities and Community Colleges	1,380,356,781	1,696,307,823	2,216,423,340	2,431,346,068	2,558,635,688	2,170,669,291
School Districts and ESDs	1,464,612,246	1,832,185,982	2,356,525,507	2,576,207,579	2,734,425,745	2,447,519,585
Local Governments	1,219,377,755	1,551,624,000	2,038,061,152	2,165,886,546	2,268,092,284	2,272,076,795
Total (systemwide)	**4,064,346,782**	**5,080,117,805**	**6,611,009,999**	**7,173,440,194**	**7,561,153,717**	**6,890,265,671**
Net PERS + Debt Service Increases Over 2017-19 Levels						
State agencies, Public Universities and Community Colleges		315,951,042	836,066,559	1,050,989,287	1,178,278,907	790,312,510
School Districts and ESDs		367,573,736	891,913,261	1,111,595,333	1,269,813,499	982,907,339
Local Governments		332,246,245	818,683,396	946,508,791	1,048,714,528	1,052,699,040
Total (systemwide)		**1,015,771,023**	**2,546,663,216**	**3,109,093,411**	**3,496,806,934**	**2,825,918,889**
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Total (systemwide)		**1,015,771,023**	**2,546,663,216**	**3,109,093,411**	**3,496,806,934**	**2,825,918,889**
Potential Revenue		**1,500,000,000**	**2,205,000,000**	**2,431,012,500**	**2,680,191,281**	**2,954,910,888**
Net PERS + Debt Service Increases Over 2017-19 Levels						
State agencies, Public Universities and Community Colleges		315,951,042	836,066,559	1,050,989,287	1,178,278,907	790,312,510
School Districts and ESDs		367,573,736	891,913,261	1,111,595,333	1,269,813,499	982,907,339
Total		**683,524,778**	**1,727,979,820**	**2,162,584,621**	**2,448,092,406**	**1,773,219,849**
Potential Revenue		**1,500,000,000**	**2,205,000,000**	**2,431,012,500**	**2,680,191,281**	**2,954,910,888**

Future Impacts of PERS Costs: K12

- **Each 1% of payroll in K12** = $66 million in 2017-19, rising to **$71 million in 2019-21**

By 2025, the share of increased PERS costs borne by school districts will amount to what it costs to pay for:

5,500 teachers **or**

22 days of school

K12: Staffing and Services Effects from Scheduled and Projected PERS Cost Increases

Biennium	Cumulative PERS Increases above 2017-19	Biennial Cost of One Teacher	Increases Equivalent to # Teachers	Marginal Cost of One School Day Biennial	Increases Equivalent to # School Days
2019-21	$367,573,736	$197,736	**1,859**	$51,610,000	**7.1**
2021-23	$891,913,261	$210,472	**4,238**	$53,703,000	**16.6**
2023-25	$1,111,595,333	$220,178	**5,049**	$55,851,120	**19.9**
2025-27	$1,269,813,499	$230,442	**5,510**	$58,085,165	**21.9**

K12: Staffing and Services Recovered from Employee Pension Cost Sharing at 6%/3%

Assumes Tier 1/2 active employee population, now 44%, declines 4%/year

Biennium	Cumulative Employer PERS Savings	Biennial Cost of One Teacher	Savings Equivalent to # Teachers	Marginal Cost of One School Day Biennial	Savings Equivalent to # School Days
2019-21	$301,921,753	$197,736	**1,527**	$51,610,000	**5.9**
2021-23	$316,593,577	$210,472	**1,504**	$53,703,000	**5.9**
2023-25	$329,383,036	$220,178	**1,496**	$55,851,120	**5.9**
2025-27	$339,775,070	$230,442	**1,474**	$58,085,165	**5.8**