

Oregon Public Employee Retirement System

Documenting the City of Grants Pass' participation in PERS



Overview of the City's Participation in Oregon PERS

Background

Approximately 55% of the City's current operating expenditures are personnel costs. This is followed by contractual services at about 25%. As Oregon PERS (Public Employees Retirement System) is a major component of overall personnel costs, it's important to explain the budgetary impact of changes to PERS rates. Like most state and local public agencies in Oregon, the City's participation in the Oregon PERS is mandatory. PERS is largely a defined benefit retirement system, and the largest revenue source for the system by far is investment returns. When investment returns temporarily fall well below projected averages, such as happened in 2008, differences between assets in the system and the actuarial liabilities of the system need to be made up over time in part through higher employer contributions. It's important to make sure the system is properly funded and continues to provide investment returns to keep up with the retirement system's contractual and legal obligations.

Public employees that participated in the PERS system prior to system changes made in 2003 receive slightly different benefits than those that started after 2003. PERS charges the City different rates for the different classes of employees and different rates for sworn personnel versus general service personnel. The City uses its insurance/benefits fund to charge slightly different rates to departments as compared to the rates paid into the PERS system to limit the drastic budgetary impact of the State's PERS rates changing every two years. There is currently a PERS reserve in the insurance fund that will be used in the future to offset the impact of rates that are set to increase every two years until the State system is fully funded again.

Budget Considerations & PERS Reserve

For the City of Grants Pass, the impact of every 3% increase to PERS rates equates to approximately \$400,000 per year in additional benefit costs for the City. On July 1, 2017, the average rate increase for Grants Pass for all the different classes of PERS staff is an estimated 3.86%. Tier 1/2 rates are set to increase 4.83% while other classes will increase between 2.81% and 3.47%. Absent additional legislation to change the benefit structure or rate setting process of the system, PERS rates are expected to increase at least 3% on average every two years again starting on July 1, 2019 until rates approach a total of close to 30% of gross payroll costs (according to PERS rate advisory and other presentations). This means rates are likely to go up again in 2019 and 2021 and remain high for many years after 2021. Rates the City pays also increased modestly starting in FY'16 but internally billed rates are scheduled to remain the same until the end of FY'18 in combination with the use of the established PERS reserve. Thanks to actions in the past in building up a PERS reserve, the City's operating budget won't be severely impacted by PERS rate changes for at least a few more years.

PERS rates billed out to City departments have been slightly different than rates paid into the system, with the difference accounted for in the Benefits Administration fund (the PERS reserve established in that fund). A City PERS reserve has been created over many past budget years by a slight difference between department charges and actual payments into the PERS system. It is estimated that this reserve will be drawn down starting in FY'18 when actual PERS rates are adjusted for the next two-year rate cycle. And unless internally billed PERS rates are slightly adjusted over the years, the drawdowns are expected to be much more severe and PERS reserves will likely begin significant declines when PERS rates change again in

FY'20. As the City's participation in PERS is mandatory, this is one of the few ways to manage the effects of large changes to PERS rates every two years.

Due largely to legislative changes made at the state level in 2013-2014 and the deferral of rate increases at the time, the City will be able to hold internally billed PERS rates the same through at least FY'18 by using a small portion of the PERS reserve in FY18. FY'20 would be the year where drawdowns would become much more severe without significant changes to internally billed rates. The following are the actual and projected PERS reserve balances assuming the next rate changes are close to expectations and assuming small adjustments to internally billed rates over the next few years:

<u>DATE</u>	<u>PERS RESERVE BALANCE PROJECTION:</u>
End of FY'16 (actual)	\$3.2 million
End of FY'17	\$3.6 million
End of FY'18	\$3.4 million
End of FY'19	\$3.4 million
End of FY'20	\$2.7 million

The PERS reserve can be found in the Support Services section of the budget and more specifically the Benefits Administration Fund. The next rate change will occur at the beginning of FY'18, followed by another rate change at the beginning of FY'20. Because the FY'16 rate increase came in slightly less than previous expectations, FY'16 and FY'17 years will continue to build on the reserve. The plan at this point is the City would begin drawing on the reserve starting in FY'18 and small incremental annual increases to internally billed rates would happen in each of the few years in combination with the use of some of the reserves. If rates are kept the same and financial markets don't perform well even more severe drawdowns of the reserve would begin in FY'20. It would be preferable to use the reserves incrementally over the next 10 years or so since rates are set to increase through 2021 and remain very high for at least 10 years after 2021. Short-term financial market fluctuations play a big role in the rate setting cycle every two years and internal and external rates will continue to be evaluated on at least an annual basis.

Current Rates & City Department Costs

Total costs billed to departments and costs by major operating divisions are presented below and on the following pages. The total cost for PERS by the major categories is provided below to provide insight into the changes over time. Remember that "Budget" will appear to jump in comparison to "Actual" given that the City frequently has unfilled positions at different times throughout the year that result in temporary expenditure savings. PERS rates are assessed as a percentage of current gross salaries.

	FY'15 Actual	FY'16 Actual	FY'17 Budget	FY'18 Budget	FY'19 Projected
PERS/OPSRP-Employee 6%	772,893	775,892	903,780	989,227	1,027,073
PERS/OPSRP-Employer	2,445,407	2,517,001	2,750,271	3,166,244	3,355,901

Total PERS Expenditures by Program Area					
	FY'15 Actual	FY'16 Actual	FY'17 Budget	FY'18 Budget	FY'19 Projected
Public Safety	2,108,694	2,121,308	2,361,613	2,557,879	2,810,121
Parks	68,748	71,709	79,483	85,246	96,274
Development	100,093	103,263	121,550	158,589	174,098
Transportation	73,766	71,060	88,072	88,221	96,318
Storm Water/Open Space	607	539	0	0	0
Water	159,193	194,408	187,949	200,376	222,849
Wastewater	154,818	175,518	180,721	194,722	218,802
Solid Waste	2,607	2,853	2,562	3,803	4,467
Administrative Services	262,575	260,755	290,553	310,425	339,775
Support Services	285,988	310,896	341,548	556,210	420,270
Lands & Building	1,211	584	0	0	0
TOTAL	3,218,300	3,312,894	3,654,051	4,155,471	4,382,974

Department	FY15 Actual	FY16 Actual	FY17 Adopted	FY18 Recommend	FY19 Projected
PUBLIC SAFETY					
PS-FIRE RESCUE DIVISION	724,663	708,236	720,542	758,284	859,133
PS-POLICE DIVISION	1,089,621	1,104,679	1,259,949	1,376,425	1,485,246
PS-SUPPORT DIVISION	294,409	308,394	381,122	423,170	465,742
	2,108,694	2,121,308	2,361,613	2,557,879	2,810,121
PARKS					
AQUATIC SERVICES	3,272	3,114	3,752	3,606	3,944
PARKS MAINTENANCE SERVICES	63,020	66,028	73,098	78,987	89,460
RECREATION SERVICES	2,456	2,566	2,633	2,653	2,870
	68,748	71,709	79,483	85,246	96,274
DEVELOPMENT					
BUILDING AND SAFETY	30,822	32,461	35,025	49,480	52,385
DOWNTOWN DEVELOPMENT	15,826	17,446	20,851	26,667	30,165
ECONOMIC DEVELOPMENT	3,180	2,087	11,590	12,379	13,982
PLANNING	49,249	50,389	53,092	68,988	76,348
TOURISM PROMOTION SERVICES	1,016	880	992	1,075	1,218
	100,093	103,263	121,550	158,589	174,098
TRANSPORTATION					
STREET & DRAINAGE MAINT	69,935	68,147	83,790	88,221	96,318
TRANSPORTATION PROJECTS	3,831	2,913	4,282	0	0
	73,766	71,060	88,072	88,221	96,318
STORM WATER & OPEN SPACE					
STORM DRAIN SDCs	607	539	0	0	0
WATER					
WATER DISTRIBUTION	72,938	84,158	98,605	108,107	118,903
WATER PROJECTS	3,550	3,540	4,156	6,427	6,989
WATER TREATMENT	82,705	106,710	85,188	85,842	96,957
	159,193	194,408	187,949	200,376	222,849
WASTEWATER					
WASTEWATER COLLECTION	60,892	65,850	69,282	79,311	88,569
WASTEWATER PROJECTS	3,965	5,173	4,156	6,426	6,989
WASTEWATER TREATMENT	89,961	104,495	107,283	108,985	123,244
	154,818	175,518	180,721	194,722	218,802
SOLID WASTE					
SOLID WASTE CONSTRUCTION	412	355	0	0	0
SOLID WASTE OPERATIONS	2,196	2,498	2,562	3,803	4,467
	2,607	2,853	2,562	3,803	4,467
ADMINISTRATIVE SERVICES					
FINANCE	147,282	152,314	167,687	181,689	198,165
HUMAN RESOURCES	41,219	38,103	38,955	40,741	44,997
LEGAL SERVICES	381	225	3,957	4,083	4,478
MANAGEMENT SERVICES	73,693	70,112	79,954	83,912	92,135
	262,575	260,755	290,553	310,425	339,775
SUPPORT SERVICES					
BENEFITS ADMINISTRATION	0	0	0	172,900	0
ENGINEERING	45,096	70,397	79,325	88,393	96,955
EQUIPMENT REPLACEMENT	7,252	0	0	0	0
GARAGE OPERATIONS	31,603	35,115	44,158	52,635	58,742
GENERAL INSURANCE	2,733	2,740	3,932	3,934	4,406
INFORMATION TECHNOLOGY	71,961	77,308	80,597	85,582	94,586
PARKS & CD MGMT SERVICES	99,368	94,137	101,026	111,700	121,082
PROPERTY MANAGEMENT	22,901	25,899	24,924	30,445	32,826
WORKERS COMP INSURANCE	5,073	5,300	7,586	10,621	11,673
	285,988	310,896	341,548	556,210	420,270
LANDS & BUILDINGS					
LANDS AND BLDGS PROJECTS	<u>1,211</u>	<u>584</u>	<u>0</u>	<u>0</u>	<u>0</u>
	3,218,300	3,312,894	3,654,051	4,155,471	4,382,974

The 6% "Pick-Up"

PERS currently requires a payment of 6% of a public employee's gross wages into the system, paid either by the employee or by the employer. Most public employers, such as the City of Grants Pass, have elected to pay the 6% on behalf of the employee as part of the overall compensation package. This allows payroll taxes to be minimized (all things being equal in terms of the total compensation package). The costs shown above include both the main PERS rate and the 6% portion.

Rate Drivers & PERS Reserve Impact

PERS rate changes are largely and directly correlated to the broad performance of financial markets, and rate changes tend to lag the actual performance of financial markets by at least two years. The FY'10 and FY'11 rates billed by PERS were reduced because of financial market performance that was healthy prior to 2008. However, knowing that 2008 was one of the worst financial market performances in many years, the City billed all departments at the same PERS rates as the previous two-year cycle and set aside additional reserves in the Benefits Administration program. Reserves have been set aside for many years by charging slightly different rates to operating departments as compared to the PERS system payment requirements, and at the peak of the PERS rate setting cycle these reserves will be used to lessen the impact of higher rates.

The State PERS Board made a policy decision to spread unfunded liabilities, largely the result of retirement benefits for Tier 1/Tier 2 employees, to all groups. As the current employee membership in Tier 1/Tier 2 has declined due to retirements, the financial impact of liabilities and financial market losses in 2008 produced staggering rate projections for these remaining Tier 1/2 employees. Government agencies have found these impacts more manageable by allocating a portion of the liabilities across all groups of employees, and so under the State's rate setting rules the liabilities are spread across all categories of PERS employees. It is also noteworthy that the State has addressed the issue of Tier1/Tier2 benefits in that since 2003 new public employees do not have the same defined benefits. However, the system remains to be partially a defined benefit plan that sets retirement benefits based on time of service rather than by how much is earned in an employee's individual retirement account and how well investments perform. This type of retirement plan is challenging to manage when retirement portfolio returns come in well under average long-term expectations, as was the case in 2008.

Due to the historic losses in financial markets in 2008 and limited recovery of the unfunded liability since that time, it is currently expected that at least 3% increases will be implemented by the state PERS program every two years starting again on July 1, 2017 and for the next couple rate cycles unless the portfolio returns come in significantly higher than assumed earning rates. Investments must return well over the assumed returns of 7.5% in order for the unfunded liability to decrease in a given year. Over the FY18 year, the City will bill all departments at rates slightly lower than what is paid into the system and begin small incremental annual increases to internally billed rates in FY19.

Actuarial liabilities compared to growth in assets for the State operated PERS system will have to be monitored to predict the impact of future rate setting cycles. Ultimately the move to create PERS reserves will lessen the future impact of PERS rate hikes towards the end of the rate increase cycle and will help smooth the potential volatility of City personnel and related benefit costs. While the City cannot

control these rates and must follow the rules of the State's system, the City has taken steps to prepare for future PERS cost increases.

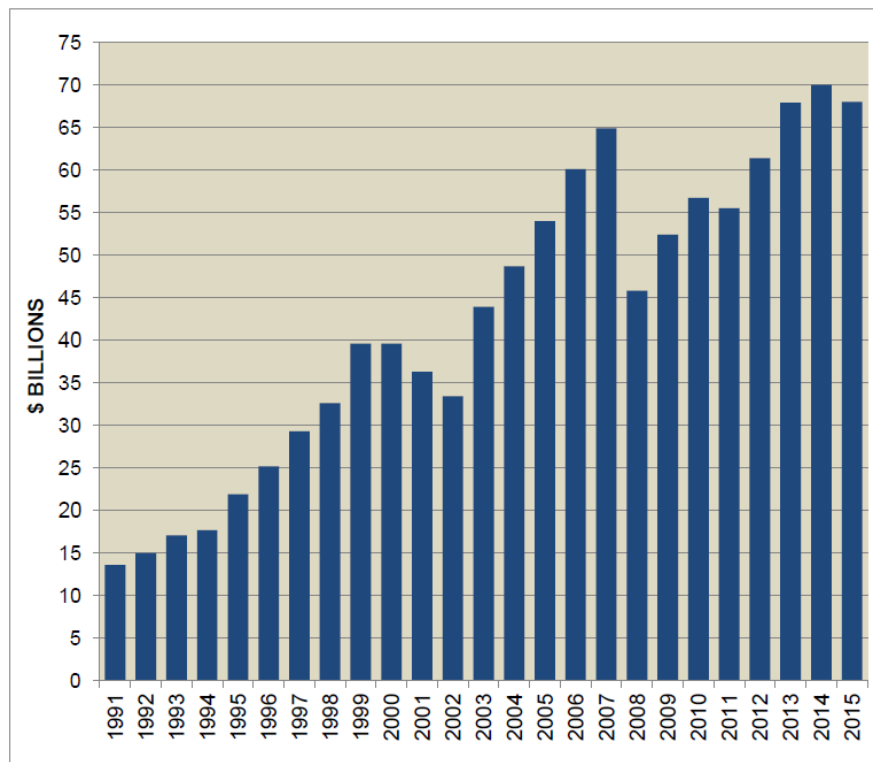
The rate increases that the City experienced starting July 1, 2015, were less than previous expectations. This is due in part to the City now being part of the State & Local Government Rate Pool for its Tier 1 and Tier 2 liabilities for the first time. Grants Pass is no longer an independent employer for the calculated liabilities for the PERS Tiers previous to OPSRP (2003), and the difference between the funded status of Grants Pass and the pool at the point where Grants Pass joined the rate pool recently, is set to be amortized over many years into the future. PERS rate changes every two years might be slightly less volatile in the future due to this change that was made in the last cycle.

Absent above average investment returns, the City of Grants Pass and almost all other public agencies in Oregon currently have an actuarial unfunded liability related to participation in PERS. Each year, PERS engages an actuary to determine the proper measure of actuarial assets, actuarial liabilities, the system's funded status, and each employer's share of assets and liabilities. Below is some information directly from PERS for a better understanding of this retirement system.

Information directly from Oregon PERS

The following charts and data points about Oregon PERS were copied from presentations created by PERS dated September 2016, titled "PERS by the Numbers" and "PERS Facts." The charts that follow highlight the importance of portfolio returns to the rate setting cycle for public agencies in Oregon.

PERS fund value (calendar years ending December 31)



3. System Funding Level and Status (continued)

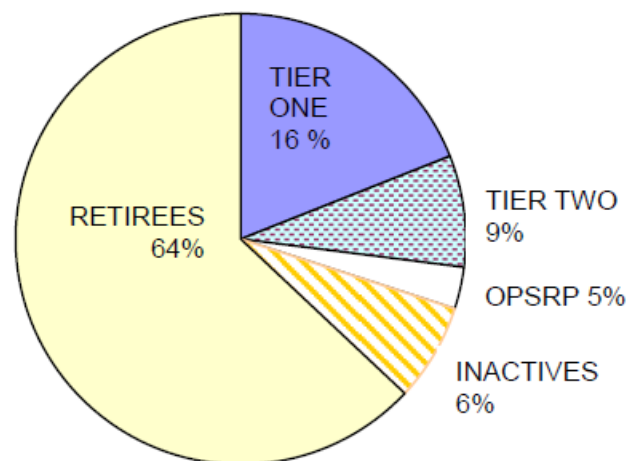
Unfunded actuarial liability history and funded ratio¹

Valuation ² Date	With Side Accounts ³ (starting in 2002)		Without Side Accounts	
	UAL (\$M)	Funded Ratio (%)	UAL (\$M)	Funded Ratio (%)
2000	1,545	96.4	1,545	96.4
2001	-2,031	105.4	-2,031	105.4
2002	3,204	92.0	3,983	89.9
2003	1,751	96.1	6,227	86.0
2004	2,122	95.6	7,678	84.0
2005	-1,751	104.0	4,919	91.0
2006	-5,019	109.7	2,229	95.7
2007	-6,120	111.5	1,538	97.1
2008	10,998	80.0	16,133	70.4
2009	8,108	86.0	13,598	76.0
2010 ⁴	7,700	87.0	13,300	78.0
2011	11,030	82.0	16,255	73.0
2012 ⁵	5,600	91.0	11,100	82.0
2013	2,600	96.0	8,500	86.0
2014 ⁶	12,100	84.0	18,000	76.0
2015	16,200	79.0	21,800	71.0

- 1 Includes RHIA/RHIPA.
- 2 2000-2003 UALs were calculated using actuarial value of assets (AVA) based on year-to-year changes in asset values smoothed over four-year periods. All other UALs since 1997 were calculated using an AVA based on fair market value.
- 3 The official PERS valuation UAL and funded ratio are based on accepted actuarial standards and methodologies. These methodologies are subject to review and revision every two years. A negative UAL amount represents a surplus.
- 4 2010 and after includes the OPSRP Pension Program, 2000-2009 reflects only Tier One/Tier Two.
- 5 Includes liability reductions from Senate Bills 822 & 861 and new Board-adopted actuarial assumptions and methods from the 2012 Experience Study.
- 6 Includes the *Moro* decision and new Board-adopted actuarial assumptions and methods from the 2014 Experience Study.

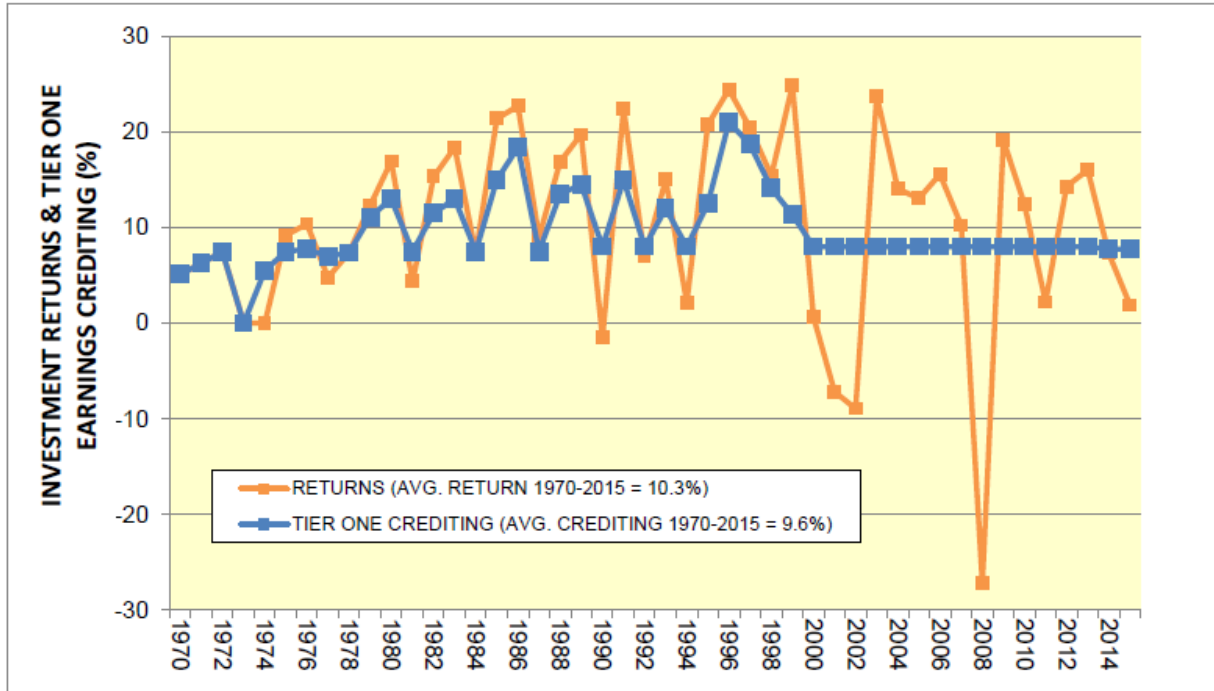
Actuarial accrued liabilities (as of December 31, 2015)

Approximately 70% of PERS' total accrued liability is for members who are no longer working in PERS-covered employment (retired and inactive members).



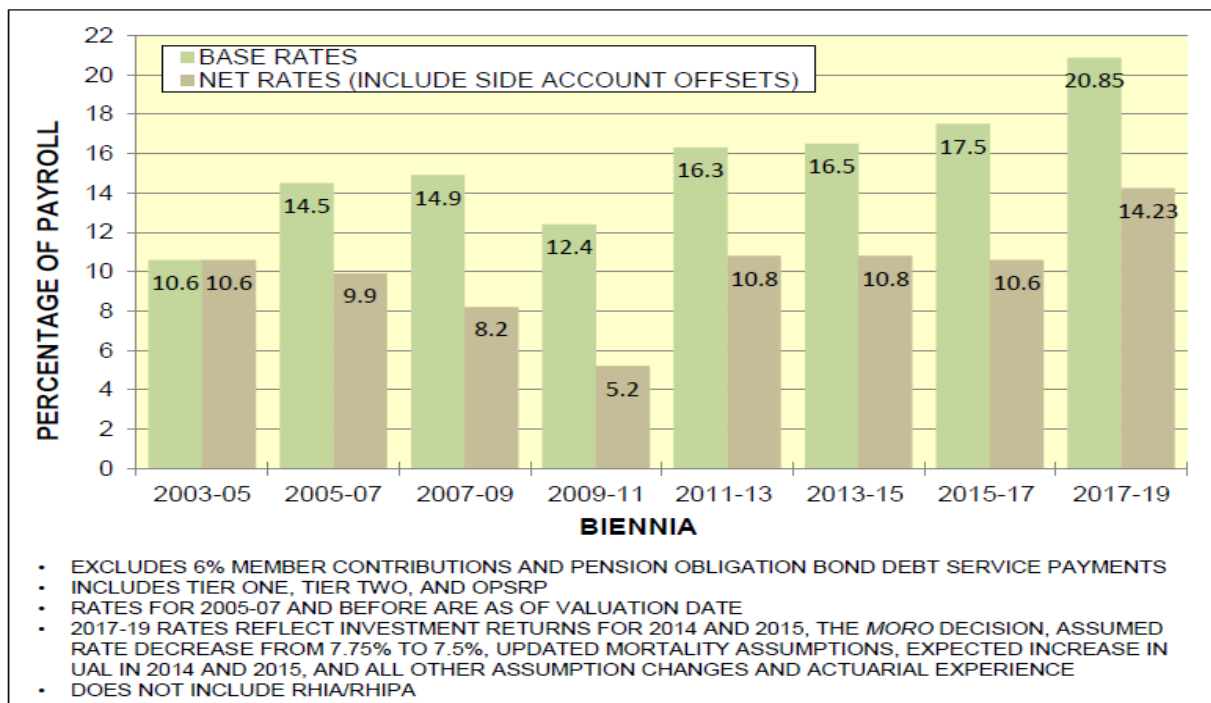
4. System Revenue (continued)

Regular account earnings available for crediting and actual distributions to Tier One member regular accounts based on 2015 earnings



4. System Revenue (continued)

System-wide average employer contribution rates as a percent of covered salary (net rates include side account offsets).



2017-19 employer contribution rate increase projections

(\$ millions)	Projected 2015-17 Payroll*	(A) Projected 2015-17 Contribution	Projected 2017-19 Payroll*	(B) Projected 2017-19 Contribution**	(B) - (A) Projected Contribution Increase
State Agencies	\$5,620	\$575	\$6,020	\$835	\$225
School Districts	\$6,120	\$560	\$6,560	\$910	\$335
All Others	<u>\$7,350</u>	<u>\$875</u>	<u>\$7,880</u>	<u>\$1,165</u>	<u>\$290</u>
Total	\$19,090	\$2,025	\$20,460	\$2,910	\$885

* Assumes payroll growth at 3.5% annually based on 12/31/2015 active member census, reflecting proportional payroll composition (Tier One/Tier Two vs. OPSRP) as of 12/31/2015.

** Collared net rates are used to project 2017-19 employer contributions.

Funding sources (1970-2015)

Money for benefit payments comes from three sources



Further information about Oregon PERS can be found on the State's website at the following address:

<http://www.oregon.gov/pers/Pages/index.aspx>