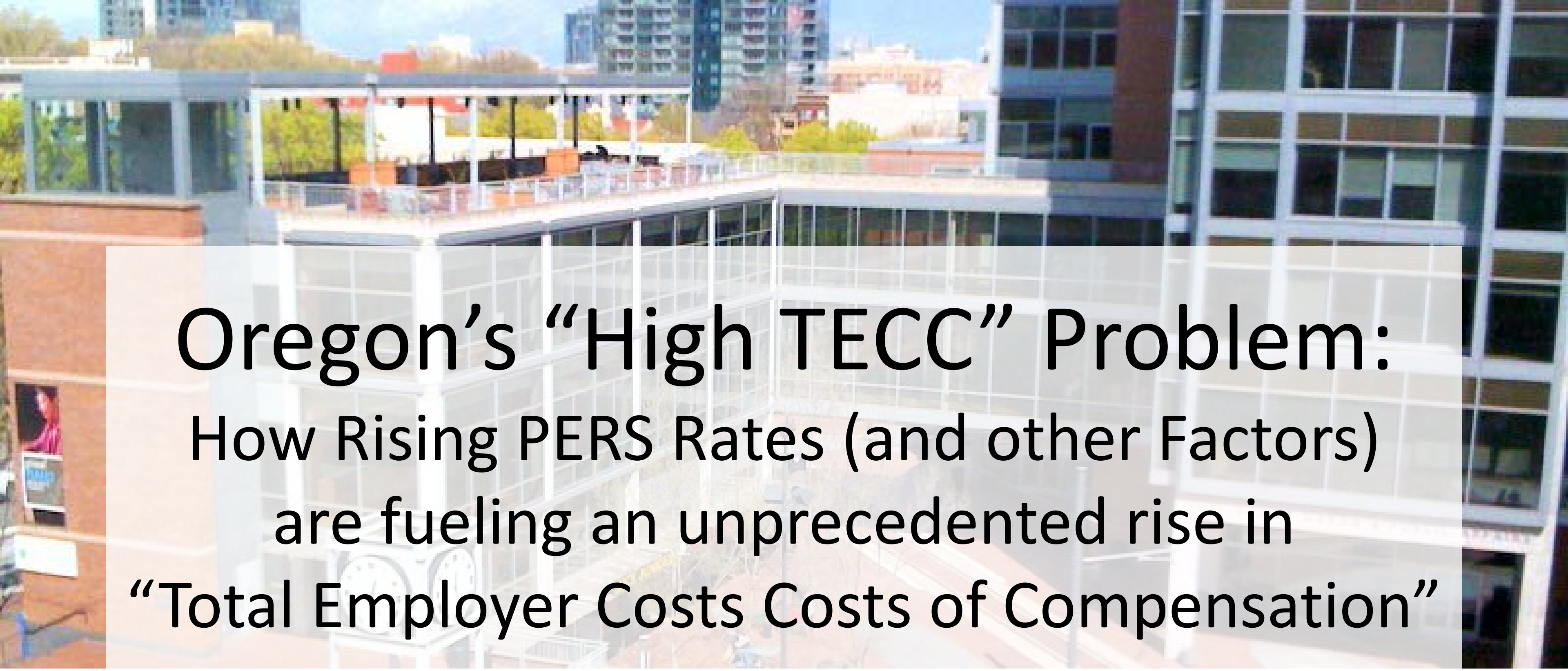


Oregon's "High TECC" Problem:

How Rising PERS Rates (and other Factors) are fueling an unprecedented rise in "Total Employer Costs Costs of Compensation"

A presentation by Phil Keisling, Director,
PSU's Center for Public Service

Western Pension and Benefits Council spring meeting–May 2, 2017

Portland State
Center for Public Service

What is "TECC?"

- For a given Job Title, "**Total Employer Cost of Compensation**" includes the following:
  - **Base salary and other pay** – e.g, specialty pay, and average overtime compensation
  - **Employer-paid health/medical benefits**: e.g, insurance, HSAs, Medicare
  - **Retirement costs** – e.g. PERS (including 6% pick up and Pension Obligation Bond costs); supplemental retirement plans; Social Security
  - **Cost of Paid Time off** – e.g., paid holidays, vacation, and other PTO
  - **Other costs** – e.g, disability insurance, workers' comp

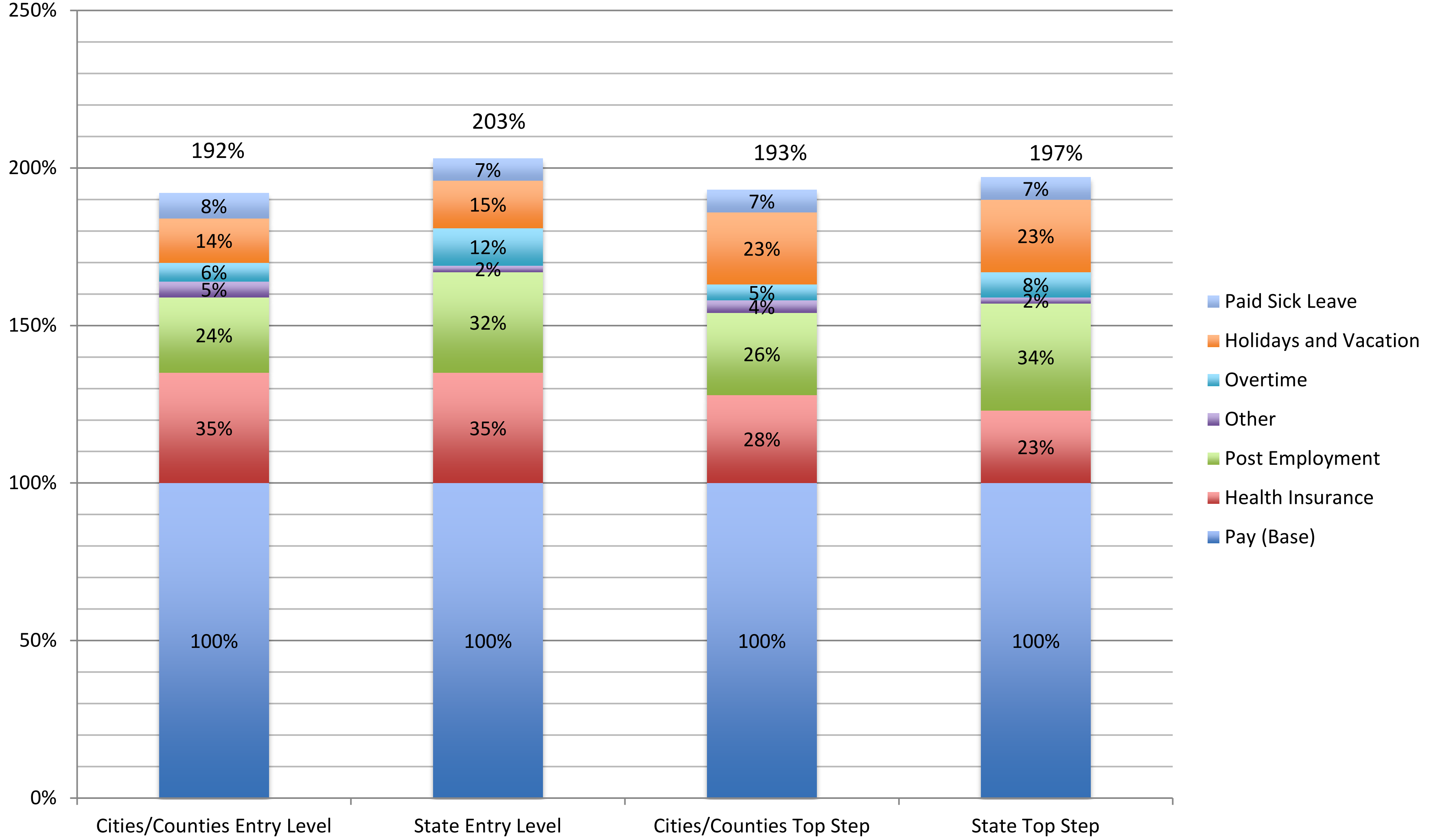
History of CPS TECC Research

- Original Report – September 2012
  - TECC team headed by CPS Fellow Bob Winthrop, and several graduate students, looked at 10 counties, 11 cities, and the state of Oregon, focusing on 13 job titles at Entry, 10-year, and 30-year stage
- With $200,000 through University Venture Development Fund (UVDF), a software-enabled benchmarking tool was released in June 2015, which now has more than 30 subscribers.

Key TECC Takeaways

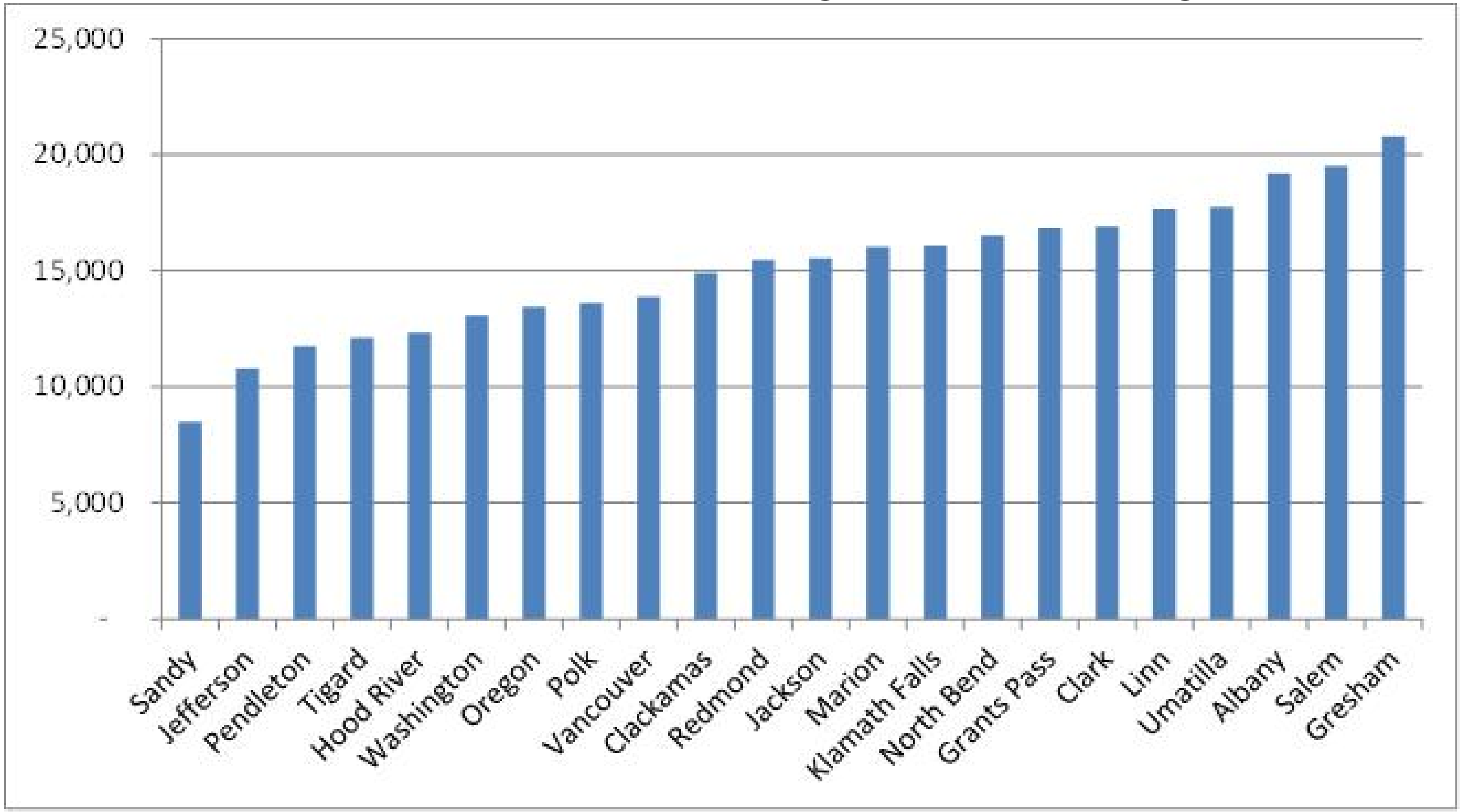
- For a given Oregon public sector job with a $50,000 base salary, TECC costs today now approximately 190-200% of that (almost $100,000)
- Costs for some key TECC components –e.g. employer paid medical insurance –vary dramatically between jurisdictions
- Some TECC costs are often overlooked – e.g, for jurisdictions whose whose “net PERS rates” are artificially low because they’re paying out 5-10% of payroll to finance “Pension Obligation Bonds”

Sept 2012 Key Findings: TECC Costs by Component



Focus on: Health Insurance Cost Variability

Figure 5.0 - General Service Employees
Dollar Cost of Health Insurance Arranged from Lowest to Highest



Why is the TECC Framework such an Important Analytic Tool?

- Many public sector officials and managers are surprised at the significant size of TECC's non-base salary component
- Many jurisdictions have experienced 10-15% reductions in their workforces during the last decade
  - How much is this due to fast-rising TECC costs, vs the recession and other factors?
- TECC is arguably a more sophisticated alternative to the "compensation as received/perceived" framework widely by public employers in collective bargaining processes and compensation studies?

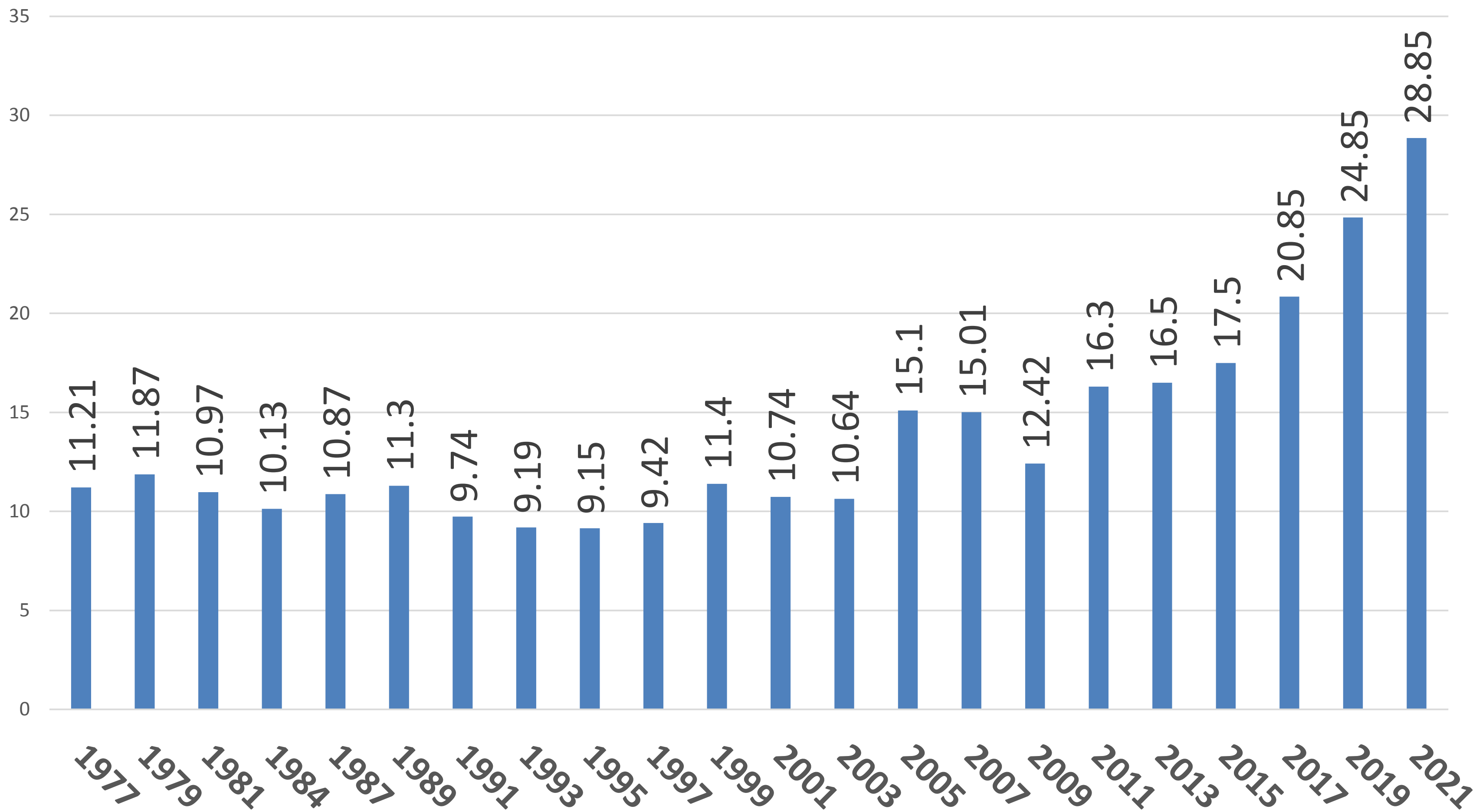
How Subscribers Use TECC

- **Longitudinal tracking**: Jurisdictions can track year-to-year changes in TECC costs for any job title, and determine which TECC components are playing the most significant roles (e.g, PERS, health insurance, overtime use, etc)
- **Education/communication**: Jurisdictions can share and discuss TECC data with employees, labor negotiators, and citizens
- **Direct Comparisons**: Through TECC's "job matching" algorithm, developed with the help of Oregon LGPI, subscribers can determine comparable TECC costs for matching jobs, regardless of job title

February 2017 Report

- Key Question: How might our TECC data base and the work done to date inform future trends in state and local government service provision?
- The Role of PERS
  - After 40 years of relative stability in net employer rates – notwithstanding two major crises (2001-03; 2009-11) – PERS rates were projected to rise steeply
- The Role/interaction of other key components:
  - E.g. projected base salary increases; health insurance costs; value of paid time off

1975-2021: After 30 years of relative stability, Collared PERS Base Employer Rates (System-wide, without side accounts) are now rapidly rising

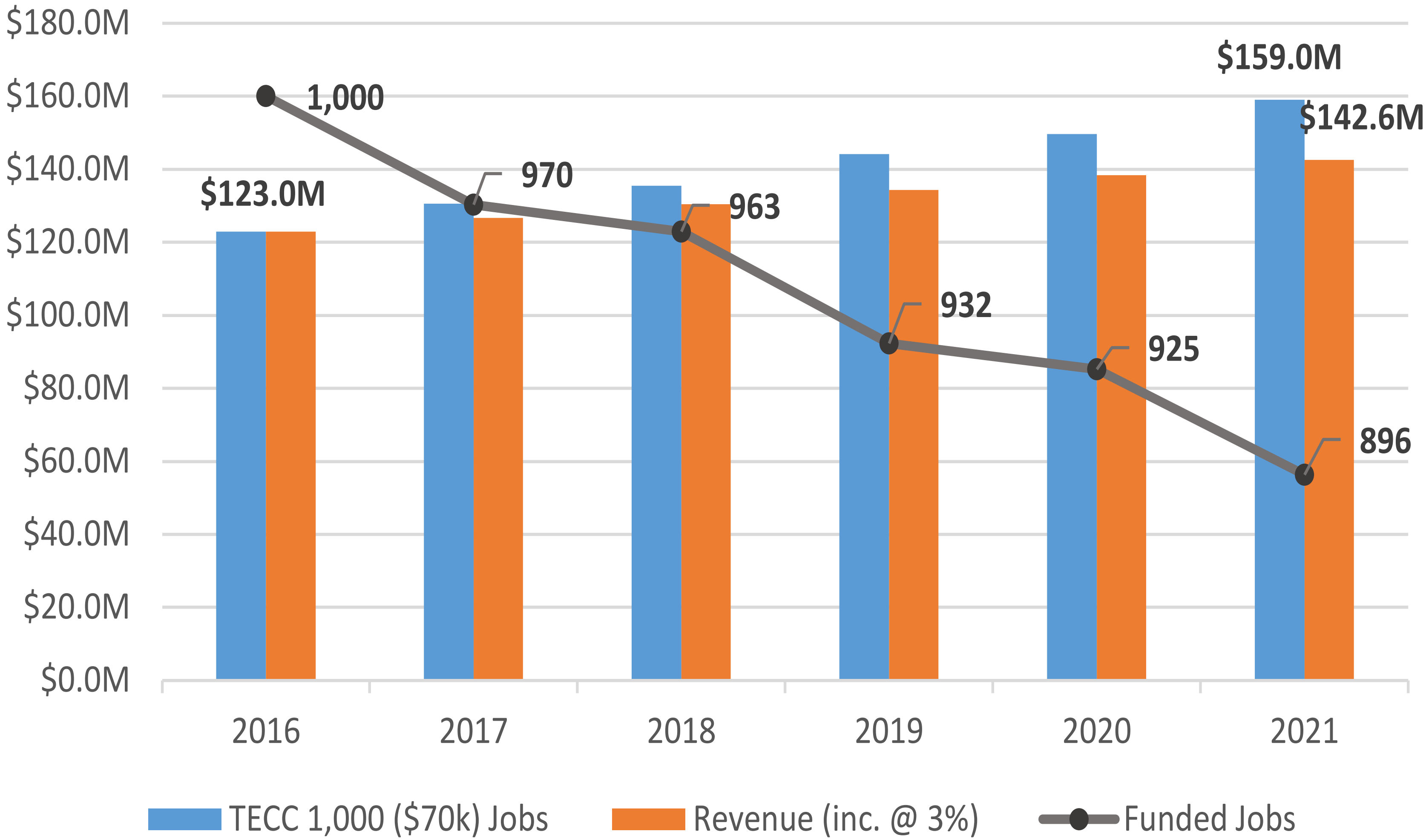


Analytical Framework for our February 2017 TECC White paper

- Build a model – a “TECC cost calculator”-- that could plug in assumptions (most of them from PERS) about projected cost increases in key TECC components:
  - Overall Payroll costs
  - PERS employer rates (collared)
  - Health insurance cost inflation
  - Paid Time Off (PTO) costs
- Assume that available revenues can cover all TECC costs in 2016-17 Fiscal year – then analyze what happens using a 3% annualized revenue increase over a 5 year period

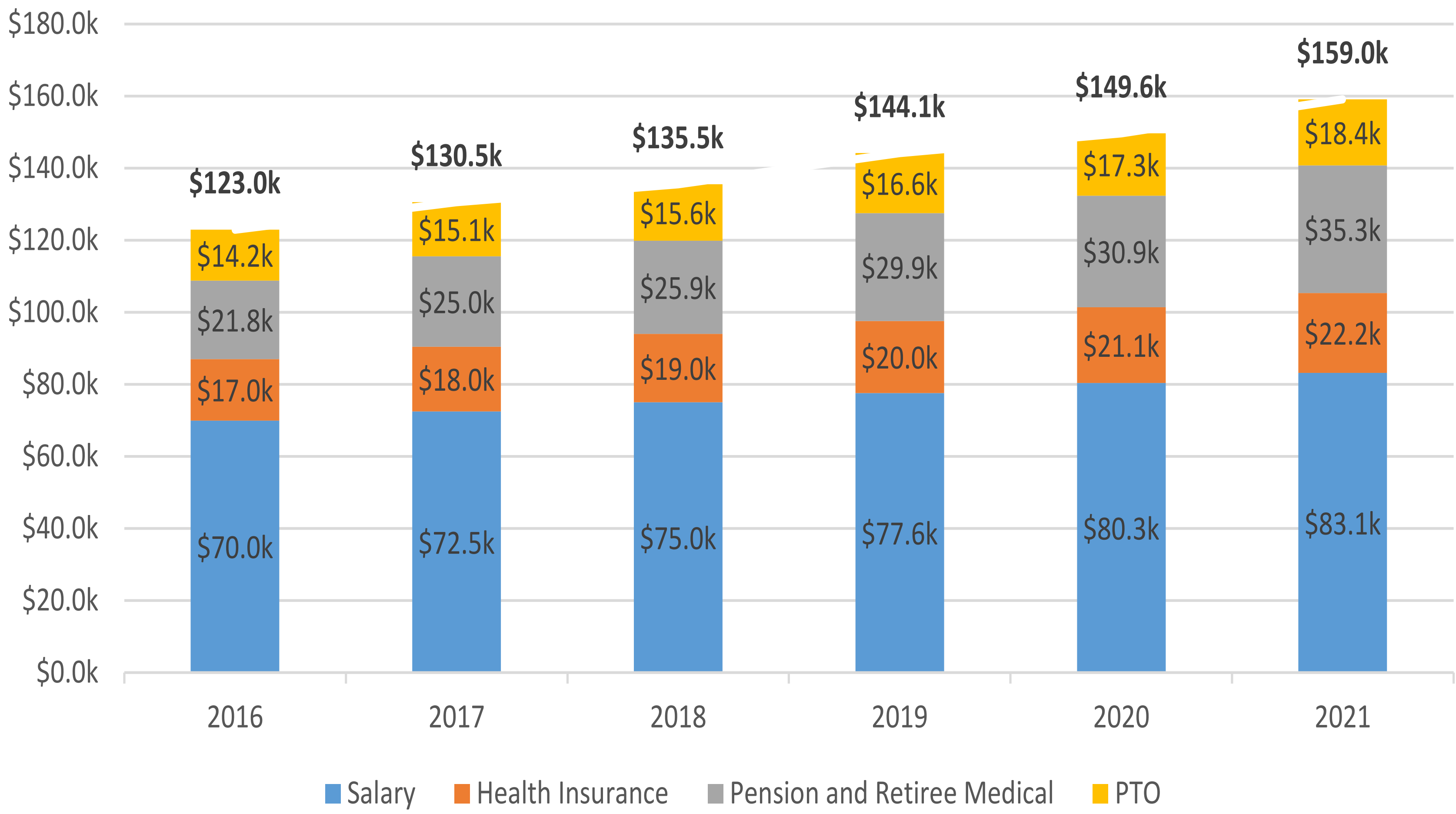
PERS Assumed TECC Trend Versus 3% Revenue Increases

Assumes no tax increase and OR PERS Valuation assumptions for health & pension increases



Expected TECC Increases, $70,000 Nominal Salary

Oregon PERS Valuation assumptions for health and pension increases



Key TECC components: Projected annual increases: FY 17-18 to FY 21-22

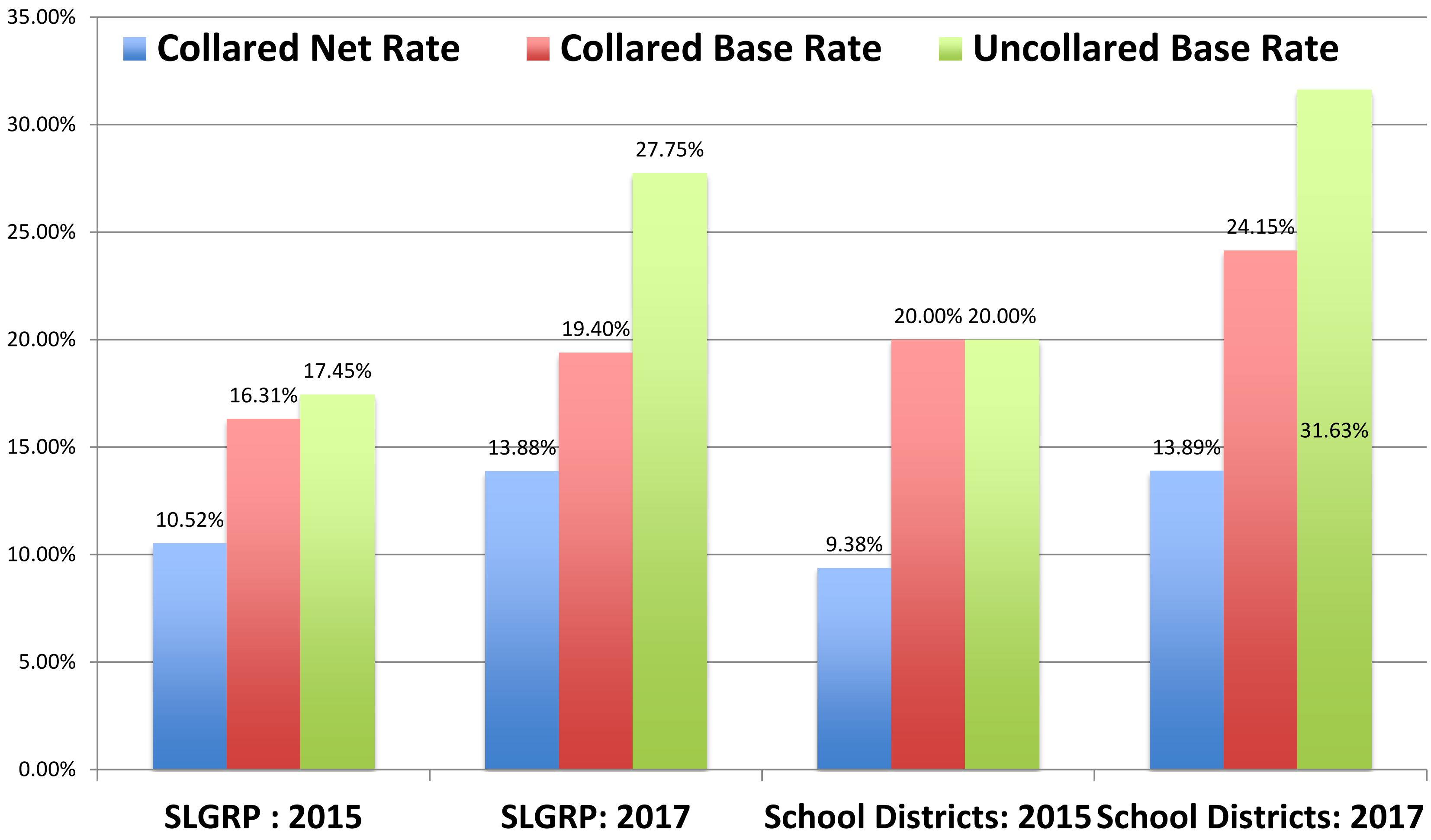
Percentage Change Results					
	2017	**2018**	**2019**	**2020**	**2021**
Salary	3.5%	3.5%	3.5%	3.5%	3.5%
Health Insurance	6.0%	5.4%	5.3%	5.4%	5.4%
Pension and Retiree Medical	14.8%	3.5%	15.5%	3.5%	14.3%
PTO	6.1%	3.8%	6.4%	3.8%	6.3%
TECC Cost	6.1%	3.8%	6.4%	3.8%	6.3%

Sources: TECC data base and PERS System annual report

Focusing on PERS: TECC's Largest (and Most Volatile) Component

- Under current law, PERS establishes employer contribution rates based on OPERF return rates, as determined every two years
  - The next critical benchmarking date will be OPERF's valuation as of 12/31/16 (CY 2015 earnings were 6.7%)
- PERS's current calculation of unfunded liabilities -- $22 billion – still assumes PERS will achieve an Assumed Earnings Rate (AER) of 7.5% a year going forward
- Even if PERS can achieve 7.5% AER, the Board's current "Rate Collar" policy allows actuarially-justified rate hikes to be deferred, but by "baking them into" future rates.

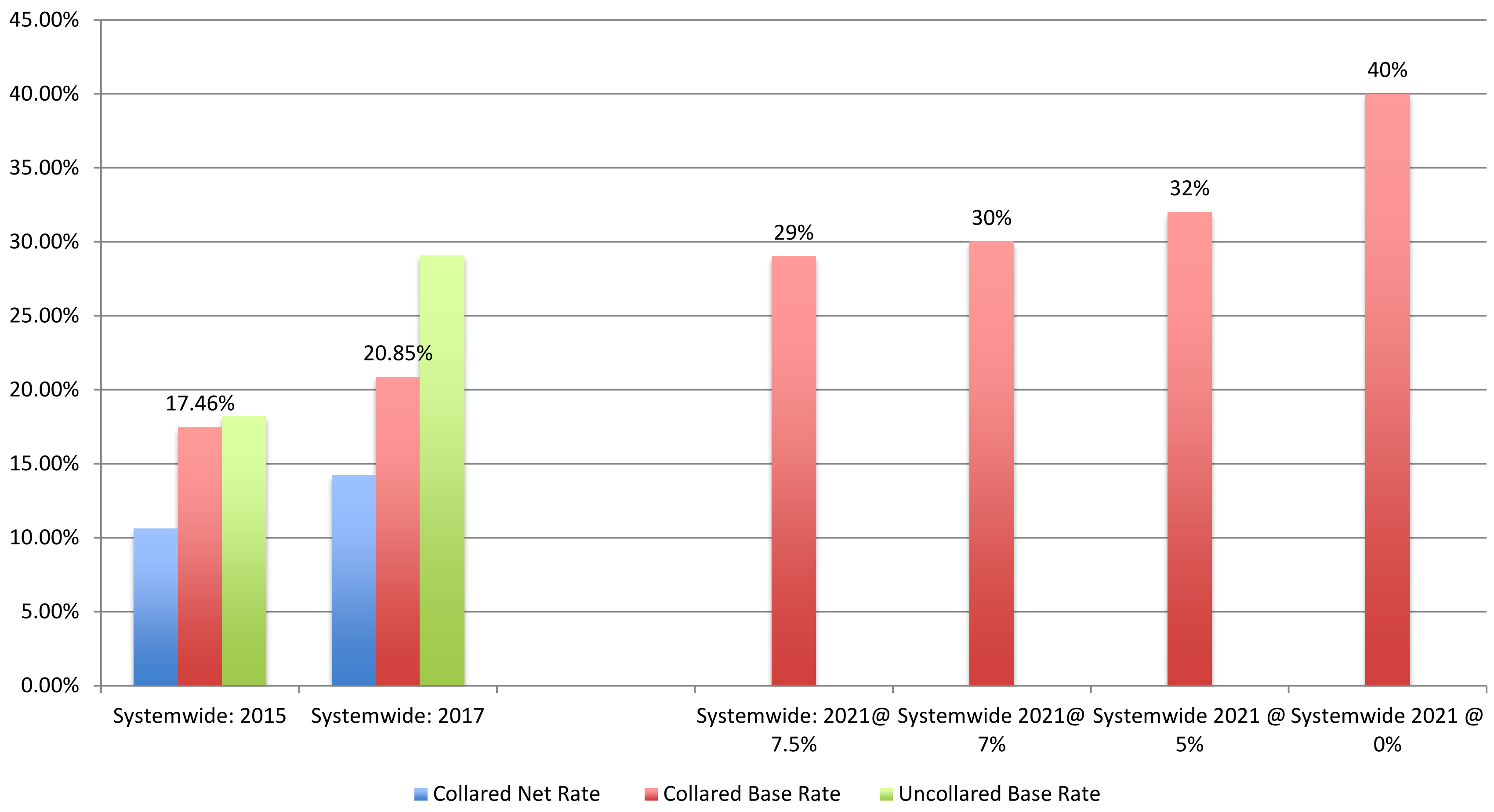
PERS Rates: Collared Net; Collared Base; and Uncollared Base



Collars and Bonds

- In the absence of PERS current “rate collar” policy, rather than see a 4% (system-wide) hike in 2017-18 PERS employer rates, we’d see a 12% annual leap
- An estimated 8% of additional PERS/TECC costs have now been deferred and “baked in” to local governments’ budgets, mostly over the next 4 years
- If anything, these next two waves of 4% increases – to hit in FY 19-20 and FY 21-22 – could be even worse, if PERS falls short of its 7.5% AER goal.

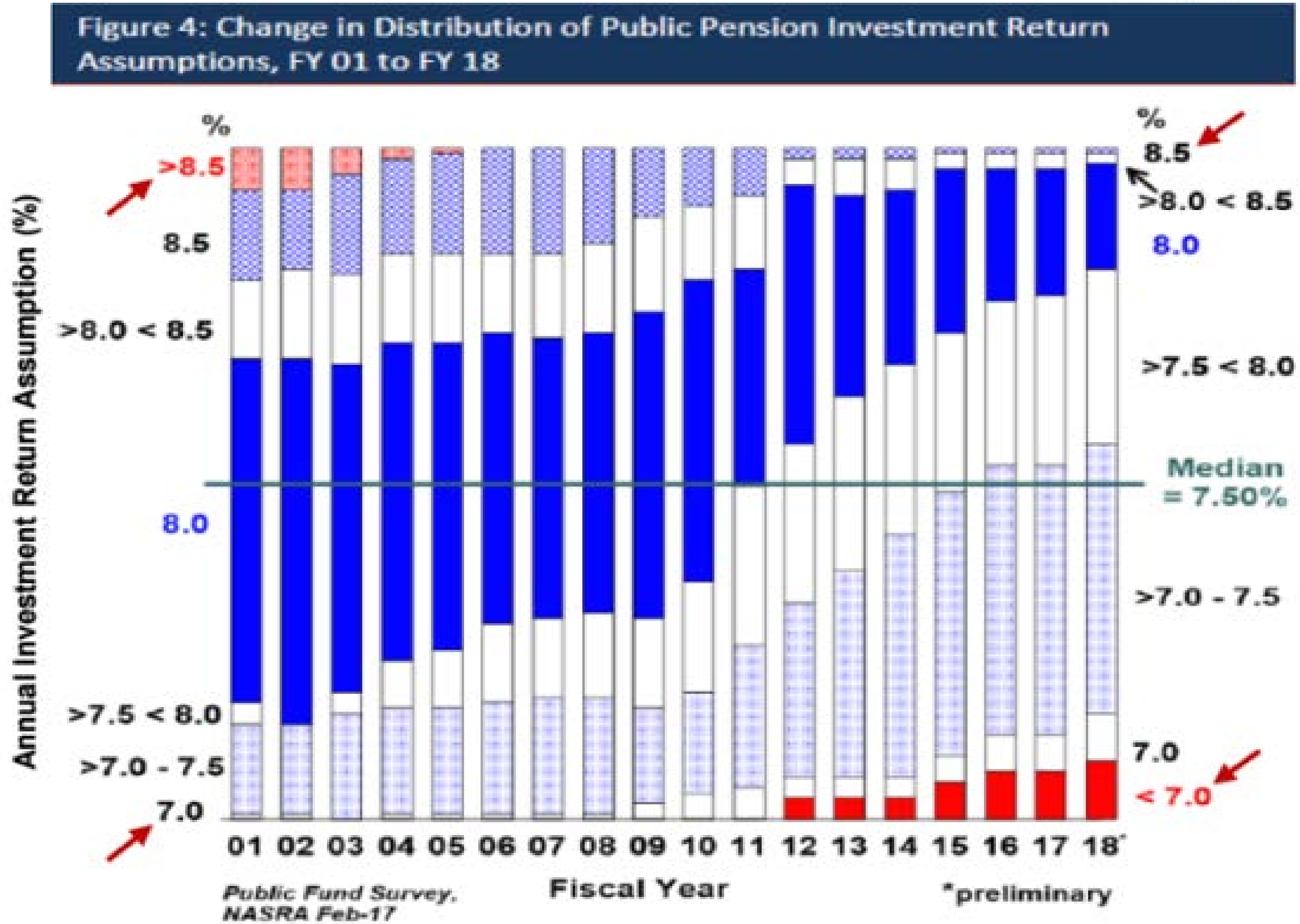
2021-22 Projected System-wide Rates: Impact of Different Return Rates



If anything our Model's Assumptions about PERS are Conservative

- Projected PERS cost hikes – from 17% to 29% in base employer contribution rates between 2017-18 and 2021-22 – are arguably conservative
- PERS still assumes a 7.5% AER rate – which is increasingly an "outlier" as states adjust their rates downward amidst a persistent "low inflation/low return" investment climate

Down-drift in the investment return environment is forcing pensions to cut their actuarial forecasts



Source: National Association of State Retirement Administrators; AllianzGI as of 2/1/17

The PERS/TECC cost Dynamic

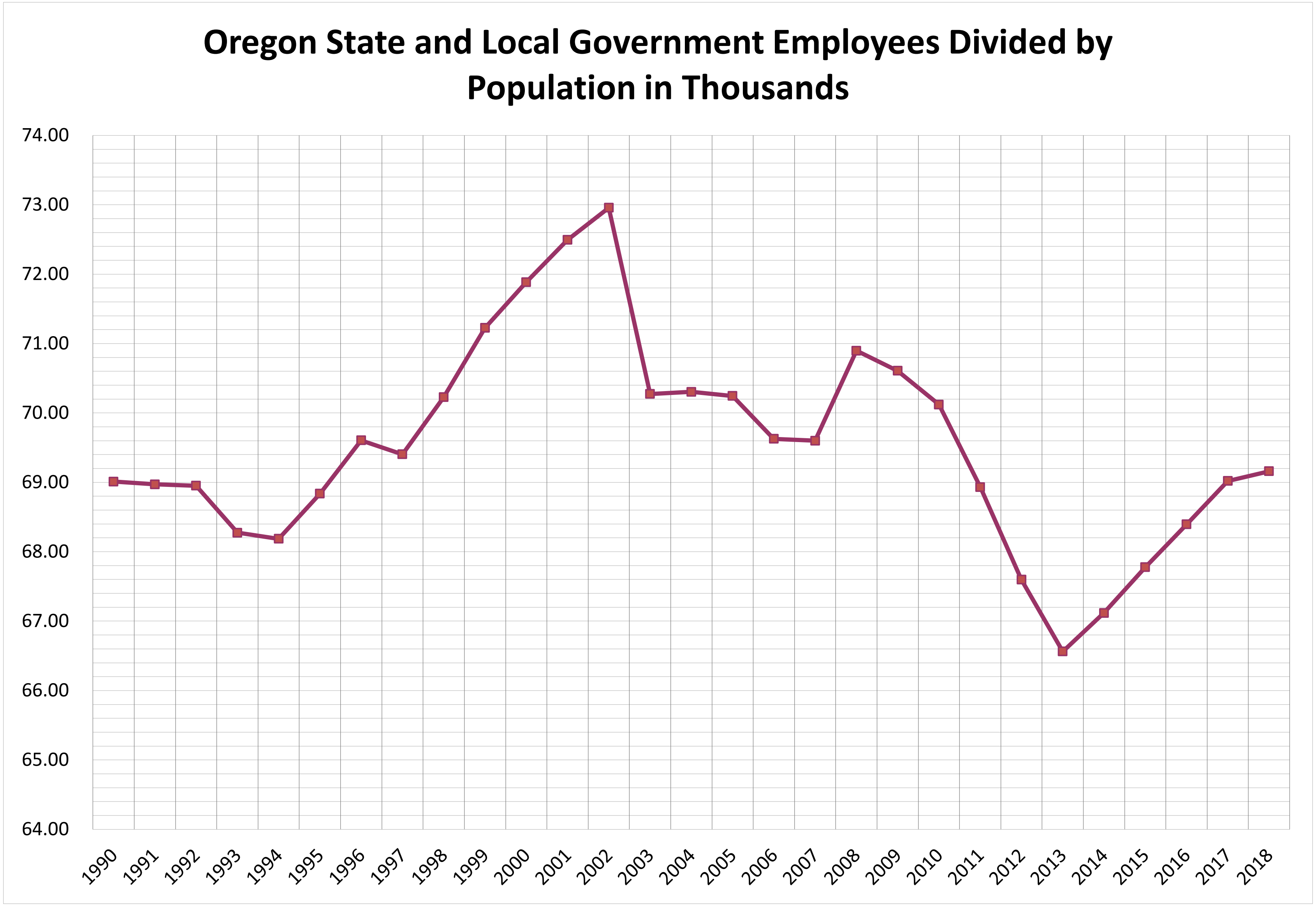
- While some possible PERS changes could reduce TECC future costs, other changes would simply postpone and/or push them higher
  - Extending the amortization schedule-- or modifying the current rate collar/double rate collar policy – would further “bake in” at least a decade of significant PERS/TECC cost hikes, even if salary growth remains largely static
  - Reducing PERS’ 7.5% Assumed Earnings Rate may be prudent – but this will also increase unfunded liabilities even further (and put even more pressure on employer contribution rates)

Contemplating some Not-So-Implausible Scenarios

- What if PERS earnings suffer another “Black Swan” earnings event– or even a “Light Gray Swan” one -- in the immediate or short term?
  - CY 2016 returns – 8 months remain – could go negative, forcing PERS to invoke its current “double rate” collar policy, pushing 2017-18 rates up by 8% or more
  - Even with decent CY 16 returns, a modest economic slowdown in the 2018-19 cycle – and disappointing PERS earnings – would bake in even more deferred rate hikes, *even if* “Golden Goose” gains of 10% or more re-appear on the back side
- And what happens if higher PERS rates coincide other negative factors – e.g, falling tax revenues, and/or a return to double digit health insurance cost hikes in an unsettled, post-ACA world?

How might these Scenarios Affect the Core Work of Government?

- Most government employees provide core services – education, public safety, health, infrastructure repair and maintenance – and overall their ranks have been thinning
- In the last quarter century, Oregon's two largest "budget crises"– the 1990 passage of Measure 5, and the 2009-13 recession -- were both driven by falling tax revenue
- These events affected state and local government employment – but nowhere near as much as people might think
  - From 1990-94 the number of state and local government workers actually grew from 198,000 to 213,000 as income tax revenue replaced property taxes
  - Between 2009 and 2013, a 3% decline occurred -- from 270,000 to 261,000



Source: Oregon Department of Employment

The Uncharted Road Ahead

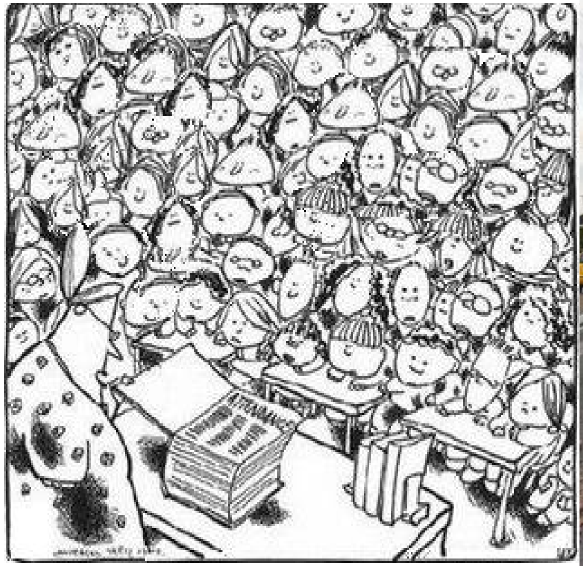
- Today's "budget crisis" is profoundly different than past events
  - Oregon's economy is enjoying a relative "boom phase" – with unemployment below 4%, and Oregon GDP growth among the nation's highest
  - No state is more reliant on a single tax source than Oregon for general fund spending – and the one we've chosen (personal income taxes) is among the most volatile

The Uncharted Road Ahead

- What happens when annual “baked in” TECC costs– not just due to PERS but other factors as well -- rise 7% or even 10% in a given year, even in good economic times?
- Which governments units are better able to respond to such new realities?
    - In good economic times, K-12 school districts, who now receive about 70% of operating revenues from state income tax receipts, are arguably better positioned than cities and counties, who mainly rely on slow-growing property tax receipts
    - In bad economic times, K-12 districts are hit even harder than cities and and counties;
    - Fee-reliant special districts arguably have more flexibility – but steep rate hikes aren’t always easy with elected boards

Final Thoughts

- While the TECC framework and the tools we're developing can't *predic*t the future, they do help us understand the interplay between key factors
- The "easiest" response to fast-rising TECC costs – which might even enjoy "bipartisan" support but for different reasons -- would be financing these TECC cost hikes via continued reductions in the public service workforce and the services provided
- The likely result: even bigger K-12 classes; fewer public safety personnel; even bigger backlogs of deferred maintenance and infrastructure spending



A Far Better Answer (IMHO)

- Recognize that changing demographics and deferred maintenance likely require the opposite: more investment capital, and higher numbers of (even higher-performing) public service personnel
- TECC at day's end is a management tool – to give elected leaders and citizens the understanding needed to maximize the value and impact of public personnel spending – and engage both citizens and their employees in a candid conversation as to how to best accomplish that

Resources

- You can find the full report and the TECC Cost Calculator here :

- https://www.pdx.edu/cps/tecc

For more information

- Thank you!
- Key contacts for additional information:
  - Phil Keisling, keisling@pdx.edu
  - Bob Winthrop, TECC project director, winthrop@pdx.edu