



INTEROFFICE MEMO

EUGENE WATER & ELECTRIC BOARD
Corporate Services Division

Rely on us.

TO: Commissioners Farmer, Brown, Cassidy, Cunningham and Ernst

FROM: Jim Origliosso

RE: PERS Funding Strategies/Actions

Issue:

The financial condition of the PERS trust fund is sensitive to fluctuations in the stock market. The most recent economic downturn has raised concerns in the media about the funding level PERS relative to its long-term liabilities and the ability of the State and other participating governmental employers such as EWEB to sustain the system while maintaining essential public services. This memo provides historical context and a range of potential future impacts of PERS costs on EWEB.

Background

EWEB has a Pension Liabilities Funding Policy which states:

“All long-term liabilities that must be either disclosed or accounted for in the financial statements will be funded according to a rational and consistent plan that targets full funding of the liabilities over a specified period of time.”

EWEB is Oregon PERS participating employer. State statutes provide that once an employer elects into PERS, it is not allowed to leave the system. Consequently, there are no provisions or ability to “buy out” of the system. Attempts to obtain buy-out legislation were made in the late 1990’s, however this was unsuccessful.

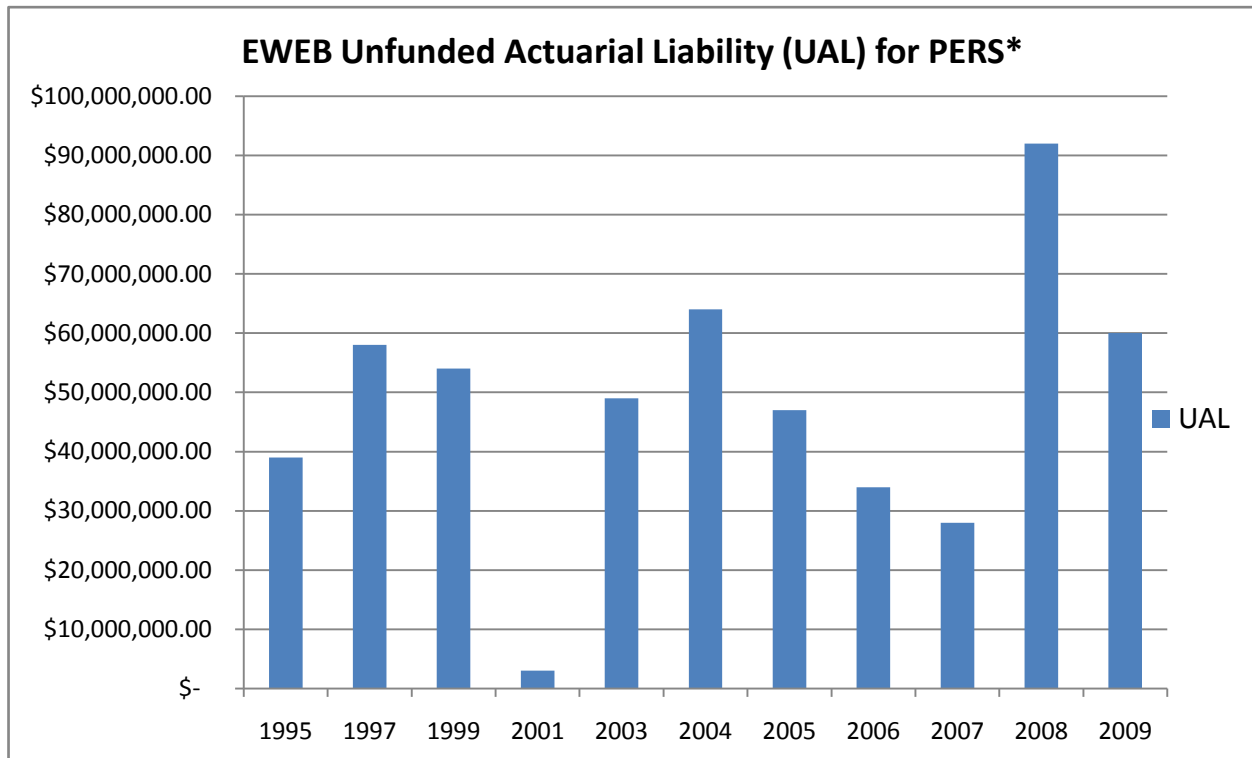
PERS contribution rates are set by the PERS Board every two years beginning on July 1 of the biennial cycle. There are two components to the rate. They are:

Normal Cost: This is the annual amount of pension benefit earned by working employees as they provide services throughout a given year, and can be thought of as the current period cost of the increment of pension benefits earned in a given year.

Amortization of the Unfunded Actuarial Liability (UAL): This is the amount owed for benefits that have been accrued, but not funded in prior years. Each year investment gains or losses are added to/subtracted from the UAL. Any normal cost for that year that has not been funded is also added to the UAL. The UAL is then amortized over a given number of years at 8% and included in contribution rates.

The contribution rate assessed by PERS is the combination of the Normal Cost and the Amortization of the UAL.

The pension liability (UAL) disclosed in the financial statements is calculated for each employer by PERS actuaries and has historically been a highly volatile number.



*Actuarial Valuations were performed every 2 years prior to 2003, then annually thereafter. Although valuations are now performed annually, the contribution rates continue to be set on a bi-annual basis using the valuations related to odd numbered years.

In addition to annual variability, the table also shows that 2008 stock market losses have had a dramatic impact on funding of the PERS system, and EWEB’s account in particular. The market has partially recovered from its lows and the 2009 bar shown above is an estimate of what the impact of the recovery has likely been.

Analysis

Every two years the PERS actuaries calculate the contribution rate that EWEB will pay. The liability is amortized over 20 years at the “assumed interest rate” (currently 8%). The UAL essentially represents an 8% loan of the unfunded amount that is carried by the State where the debt service is paid as a portion of the employer contribution rate.

There are two approaches to reducing the unfunded liability over time. For discussion purposes these are 1) Rate approach and 2) Lump sum approach. In the rate approach EWEB does nothing more than pay the contribution rates ordered by the PERS Board. Theoretically, the unfunded liability is paid down each year by the amount included in the rates and is ultimately eliminated. In the lump sum approach EWEB pays down a portion of the unfunded liability, essentially pre-paying on the loan and avoiding the 8% interest.

In 2001, EWEB was one of three employers (City of Portland and Multnomah Co. were the others)

to issue taxable bonds to provide a lump sum payment. EWEB obtained \$60 million in bond authorization and issued \$30 million of taxable bonds at 6.68%. This had the effect of essentially arbitraging the PERS debt and saving 1.3 % annually amounting to \$3.7 million savings on a net present value basis.

Shortly thereafter, PERS implemented a different approach for handling any new lump sum payments deposited after 2001. This approach is called "side accounts". Side account deposits did not automatically get credited at 8%, but rather were credited a variable amount based on the performance of PERS investments. Many employers then issued taxable debt as EWEB had done and PERS accounted for their deposits in these side accounts. EWEB did not issue additional debt, however it did deposit \$7 million of surplus cash into its side account. As of 12/31/08 this side account was valued at \$5 million. Many employers who did issue debt to fund their side accounts initially had favorable arbitrage results as the side accounts were credited substantially more than 8% due to investment performance. Due the stock market downturn most of these side accounts are currently "underwater" with the current value of their accounts substantially less that the amounts borrowed.

EWEB retail rates and 2010 budgets are set at a level that assumes the PERS contribution rate is 22% of payroll not including the 6% employee pickup. The current rate being paid to PERS is 16.81% without the pickup. The difference between the budgeted rate and the actual rate (5.19% of payroll) is currently being retained on EWEB's balance sheet in the Medical and Pension Reserve.

PERS is expected to make its next adjustment to contribution rates effective July 1, 2011 based on markets conditions as they exist on December 31, 2009. PERS' actuary estimates the contribution rate effective July 1, 2011 will be 22.81%. Were this to happen, the current allocation in the EWEB budget would approximately equal the PERS contribution rate.

Recommendation

This memo is informational and no action is requested at this time.