MEMORANDUM

EUGENE WATER & ELECTRIC BOARD

Rely on us.

TO: Commissioners Helgeson, Brown, Mital, Simpson and Carlson

FROM: Sue Fahey, Chief Financial Officer; TiaMarie Harwood, Interim General Accounting Supervisor

DATE: October 27, 2017

SUBJECT: PERS Liability Mitigation Strategy

OBJECTIVE: Board Direction

Issue

Financial Policy 1.4 - Retirement Benefits Funding Policy requires that if the funded status of EWEB's pension plan drops to 70% or less, an assessment of accelerated funding will be performed. The December 31, 2015 actuarial valuation prepared for EWEB by the Oregon Public Employees Retirement System (OPERS) actuary indicated that EWEB's Unfunded Actuarial Liability (UAL) was in excess of $112 million and funded at 69%.

In September, the December 31, 2016 OPERS system-wide results were released. The OPERS UAL rose from $21.8 billion at the end of 2015 to $25.3 billion, and the funded status dropped from 71% to 69%. OPERS will provide employer specific information later in November; however it is anticipated that EWEB's funded status will fall further.

Background

EWEB is an independent employer participating in OPERS. As such, the actuarial liability is calculated on EWEB's specific employee and retiree demographics, and EWEB assumes all risk for changes in those demographics. The largest components of the employer rates are the normal cost which is the projected cost of providing expected benefits for current employees, and the UAL which is the difference between the actual cost of pension benefits (liabilities) and assets (contributions plus investment earnings) at a particular point in time. All other assumptions being the same, when EWEB's PERS covered wages decrease, the normal cost rate would also decrease (less current employee benefits). The UAL rate would increase since the wages available to pay down the UAL are lower.

By the early 2000's the OPERS system-wide UAL was growing rapidly due in part to inaccurate retirement formula and mortality assumptions, underfunded reserves, poor investment returns and crediting employee accounts with earnings above the assumed rate. EWEB's employer contribution rate rose from 12.16% in the July 1997-June 1999 biennium to 21.76% for the July 1999-June 2001 biennium. EWEB, City of Eugene and several other public employers filed a lawsuit against the PERS Board (PERB) in 1999 claiming that the PERB failed their fiduciary responsibility and did not administer the system for long-term viability. The lawsuit was successful, and legislative changes were made in 2003 that slowed the UAL increase. Investment income accounts for approximately

75% of OPERS' revenues and investment returns were frequently below the 8% assumed earnings rate. Accordingly, the UAL continued to rise.

To mitigate the rising UAL, EWEB issued $30 million of PERS bonds in May 2001. Those bonds were defeased in June 2017. In November 2006, EWEB also deposited $7.2 million with PERS to pay down the UAL. OPERS places lump sum payments in a side account for the employer's benefit. EWEB's current rates are reduced by 1.22 percentage points for the side account which has approximately $5 million remaining. One percentage point reduction in employer PERS rates reduces costs by approximately $400,000.

EWEB's current melded employer rate is 24.11%; however OPERS 'collars' rate increases to shield employers from dramatic rate changes. EWEB's rates for the 2017-2019 biennium were reduced by 6.23 percentage points as a result of the collar calculation, and future rates will increase higher because of the collar.

Both Utilities have cash in excess of targets. As of October 26, 2017, the Electric Utility had $135 million in working cash and Board designated funds, and the Water Utility had $30 million. Targets for the Electric and Water Utilities are $71.7 million and $12.7 million, respectively. The Electric Utility has $13.8 million in the designated pension fund, and the Water Utility has $4.3 million. In 2013, $5.7 million of Electric pension funds were used to pay down EWEB's Other Post-employment benefit UAL. At that time, the Water Utility had not yet established a pension fund due to low cash reserve levels. Balances in the designated pension fund have grown over the last few years primarily due to the PERS Board adopting artificially low rates based on legislation that was eventually overturned. Per Financial Policy 1.4, approximately $2 million will be added to the pension reserve at the end of 2017. The Schedule of Reserves as of October 26, 2017 are included as Attachment 1.

After the 2017 legislative session didn't yield PERS reform, Governor Brown appointed a PERS task force that was charged with finding ways to reduce the PERS UAL by $5 billion. The group is scheduled to provide their report on November 1st. Information regarding the task force's ideas will be provided at the November 7th Board meeting.

Discussion

The Board has five options regarding the PERS liability:

1. Do nothing and pay the employer rate calculated biennially
2. Issue additional PERS bonds
3. Set up an EWEB managed trust
4. Deposit additional funds into a new side account
5. Join the State and Local Government Rate Pool (SLGRP) and pay off part or all of the Transition Liability

1. *<u>Do Nothing</u>*

Pros: Easiest, no cost, retains cash

Cons: Rates will increase significantly in next few biennia due to EWEB's rate collar; doesn't address long-term issues; higher rates will result in lower debt service coverage and additional customer rate pressure

Additional information: As of September 2017, retained cash was yielding an average 1.2%.

2. *Issue PERS Bonds*
   Pros: Reduces PERS Liability; reduces Operations & Maintenance (O&M) costs
   Cons: Cost to issue bonds; negative impact on debt service coverage which could result in additional customer rate pressure; bonds are taxable and carry a higher interest cost
   Additional information: Actual savings would depend on investment earnings versus bond interest

3. *EWEB Trust*
   Pros: EWEB retains control over cash
   Cons: Initial and ongoing costs; no internal expertise; reduced investment options compared to Oregon Investment Council; operational work to set up PERS side accounts each time transfers are made
   Additional information: Investment earnings vary with market and management strategy.

4. *Deposit Funds into a New Side Account*
   Pros: Reduces PERS liability; reduces O&M costs; positive impact on debt service coverage, reduces rate pressure; minimal cost to set up account; reduced rates take effect shortly after deposit
   Cons: Reduces cash reserves
   Additional Information: Investment earnings will vary with market; each $5 million deposited is projected to reduce the rate .8% if deposit earns assumed rate of 7.2%

5. *Join SLGRP and Pay Off Part or All of the Transition Liability*
   Pros: Mitigates independent employer risk (particularly in declining wage periods); reduces PERS liability; reduces O&M costs; positive impact on debt service coverage; minimal cost to join; reduces rate pressure; PERS charges assumed rate (currently 7.2%) on transition liability. Using reserves earning less than 1.5% to pay off transition liability provides immediate savings; retains cash for over a year
   Cons: Reduces cash reserves; loss of independence; transition liability and rates unknown at time of enrollment; rate reduction would not take effect until July 2019
   Additional information: Calculation as of the 12/31/14 and 12/31/15 valuations indicated PERS rates would drop approximately 2 percentage points; most recent transition liability was $26.8 million which if paid off would reduce rates 4.7 percentage points; deposit would not be made until 2019

Recommendation

Management recommends joining the SLGRP and paying off or down the transition liability. The decision of how much to pay off would be made at the end of 2018.

Requested Board Action

None at this time. Management is requesting that the Board provide direction on the PERS liability mitigation strategies. At the December 2017 meeting, a recommendation will be provided for Board consideration.

Attachment 1: Schedule of Cash Reserves

ATTACHMENT 1

Water Utility Schedule of Cash Reserves

		FINANCIAL POLICY REFERENCE	TARGET	BALANCE 10/26/2017
	Working Cash	Rate Sufficiency	**$ 3,400,000**	**$ 9,128,534**

DESIGNATED FUNDS

	Operating Reserve	Rate Stability	$ 1,000,000	$ 1,012,184
	Self-Insurance Reserve	Rate Stability	280,000	288,712
	Capital Improvement Reserve	Capital Reserve	7,000,000	7,676,194
	Rate Stabilization Fund	Rate Stability	1,000,000	1,307,263
	Water Stewardship Fund- Septic Repairs		-	87,469
	Business Growth & Retention Loan Fund		-	175,454
	McKenzie River Trust Commitment		-	250,000
	Alternate Water Supply Fund		-	6,023,464
	Pension & Post Retirement Medical Fund		-	4,389,312
	DESIGNATED FUNDS TOTAL		**$ 9,280,000**	**$ 21,210,052**
	CASH & DESIGNATED FUNDS TOTAL		**$ 12,680,000**	**$ 30,338,586**

Electric Utility Schedule of Cash Reserves

		FINANCIAL POLICY REFERENCE	TARGET	BALANCE 10/26/2017
	Working Cash	Rate Sufficiency	**$ 24,000,000**	**$ 42,175,381**

DESIGNATED FUNDS

	Operating Reserve	Rate Stability	$ 2,000,000	$ 2,082,704
	Self-Insurance Reserve	Rate Stability	1,720,000	1,773,975
	Power Reserve	Rate Stability	17,000,000	17,000,000
	Capital Improvement Reserve	Capital Reserve	22,000,000	24,688,818
	Rate Stabilization Fund	Rate Stability	5,000,000	31,298,759
	Business Growth & Retention Loan Fund		-	1,963,913
	McKenzie River Trust Commitment		-	250,000
	Pension & Post Retirement Medical Fund		-	13,849,929
	DESIGNATED FUNDS TOTAL		**$ 47,720,000**	**$ 92,908,098**
	CASH & DESIGNATED FUNDS TOTAL		**$ 71,720,000**	**$ 135,083,479**