Issue Brief

Given PERS Cost Growth, Will $2 Billion in Added Revenue Reach Students?

Oregon Legislators are considering a $2 billion tax increase to boost education investment and outcomes. Additional resources are intended to enhance career and technical education, mental health services, additional school days, and smaller class sizes.

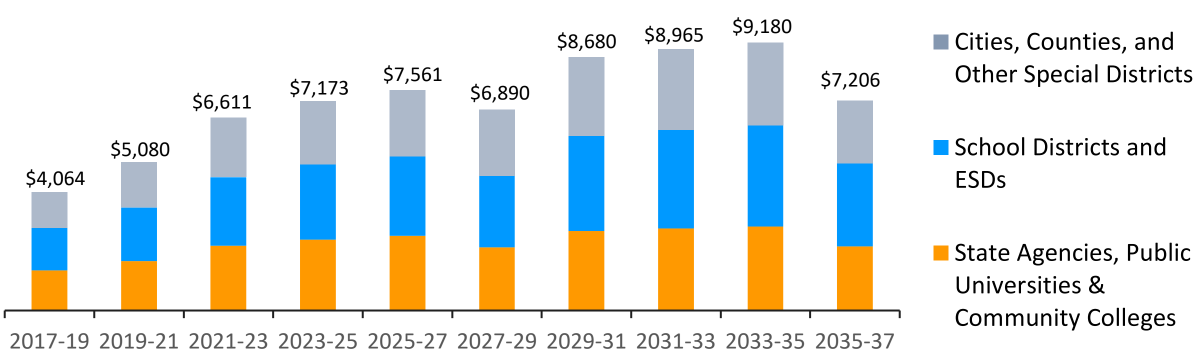
There's no question that Oregon needs to raise its investment in education, but if such a tax increase is adopted, how much of it will actually reach classrooms and students? Looming in the background of any revenue increase are even larger increases in payments that schools, universities, state agencies, and local governments will have to make into the Public Employee Retirement System. That's because PERS costs have first claim on new revenue. Dollars captured by PERS obligations will not be available for programs and services intended to improve student outcomes.

It's reasonable to explore how a $2 billion tax increase stacks up against looming PERS cost increases. This paper looks at projected PERS cost growth, how new revenue will fare against this growth absent PERS reform, and the impact on various jurisdictions who face rising PERS claims on their budgets.

PERS Costs Are Expected to Soar Over the Next Decade

As the chart below shows, in the current biennium employers across Oregon will collectively pay $4 billion in PERS-related costs.[1] This $4 billion is divided among three categories: 1) cities, counties, and special districts, 2) school districts (including education service districts), and 3) state agencies and institutions of higher education. As shown in Chart 1, PERS contributions across these employers are expected to nearly double over the next eight years and then reach $9 billion by 2031.[2] PERS costs are not expected to taper off in any sustained fashion until the mid-to-late 2030s.

Chart 1. Total Biennial PERS Contributions and Debt Service Costs (Millions)

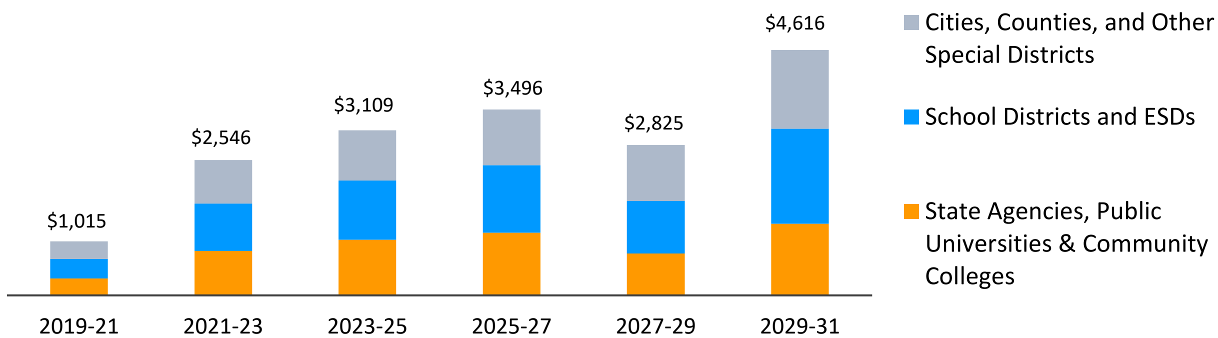


Source: OBC analysis of PERS Employer Projection Tool data and data provided by State Department of the Treasury for Pension Obligation Bond debt service costs.

[1] This includes direct PERS costs and debt service on pension obligation bonds (POBs). These are bonds that jurisdictions issue and use the proceeds, plus investment returns, to pay for PERS costs. System-wide, public employers pay more than $1 billion per biennium in debt service for pension obligation bonds.

[2] The dip in 2027-2029 and subsequent spike in 2029-2031 are the result of the expiration of POBs. Jurisdictions will stop paying the debt service on the bonds in 2027-29, but then the proceeds of those bonds—which are paying down PERS costs—run out in 2029-31.

Chart 2. Biennial PERS and Debt Service Costs Above Current Levels (Millions)



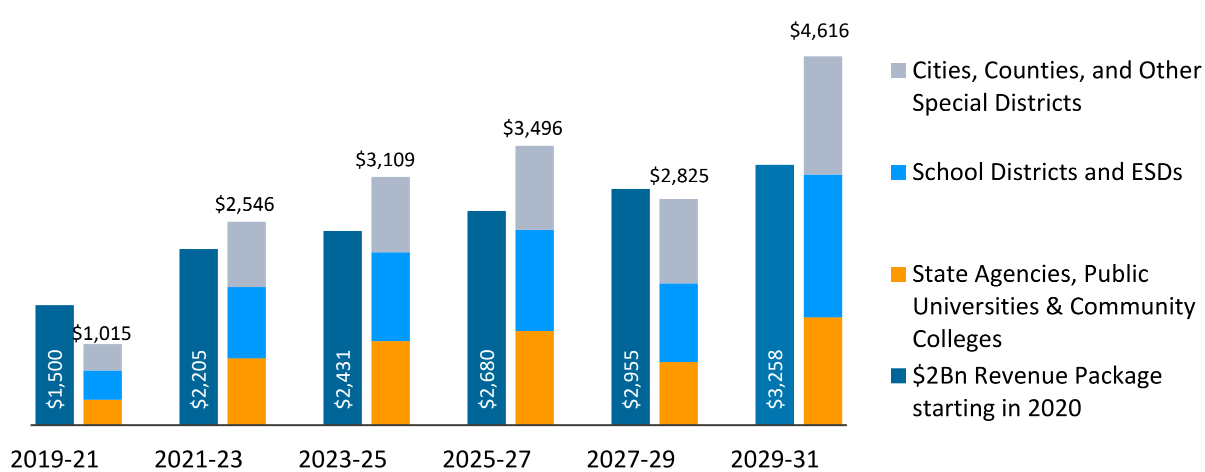
Source: OBC analysis of PERS Employer Projection Tool data and data provided by State Department of the Treasury for POB debt service costs.

Chart 2 above presents similar information, but looks only at PERS costs *over and above* levels paid in the current biennium (2017-2019). When PERS costs increase in one biennium, they become a baked-in, recurring cost for public employers that carries forward to future biennia. PERS-related expenditures for all employers are expected to increase by $1 billion from 2017-19 to 2019-21. Public employers are expected to face another $1.5 billion increase in 2021-23, for a total increase of $2.5 billion above current levels. By 2023-2025, the total PERS bill for Oregon's public employers will be more than $3 billion higher than it is today, and by 2029-2031 it will be more than $4.6 billion higher.[3]

These PERS Increases/Obligations Will Have First Call Over Other Priorities for New Revenue

Legislators are considering passing the largest package of new revenues in Oregon's history ($2 billion) to support needed improvements in educational outcomes. But without PERS reform, a large portion of any new revenues passed will have to first pay down PERS obligations.

Chart 3. Biennial PERS and Debt Service Costs Above Current Levels Compared to Potential $2 Billion Revenue Package (Millions)



Source: OBC analysis of PERS Employer Projection Tool data, data provided by State Department of the Treasury for POB debt service costs, and Legislative Revenue Office Public Finance: Basic Facts, 2019

[3] These increases are on top of a roughly $1 billion increase that occurred between 2015-2017 and 2017-2019.

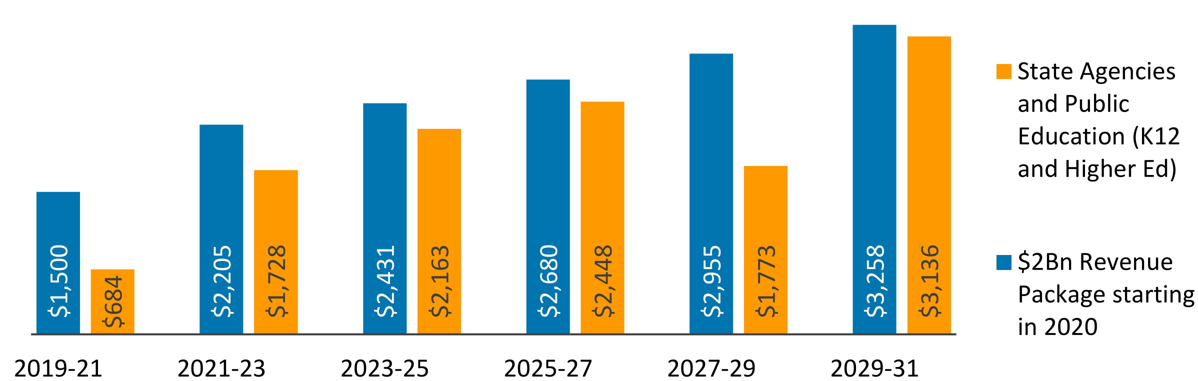
New Revenue Won't Keep Pace With Rising PERS Costs and Won't Help Cities and Counties

$2 Billion Revenue Package vs. PERS Cost Growth for All Employers. As Chart 3 above shows, if a revenue package that raises roughly $2 billion per biennium goes into effect January 2020 (a quarter of the way through the upcoming biennium) and grows over time with the economy,[4] it won't keep pace with rising PERS costs for all public employers. By the first full biennium of the new tax's implementation (2021-2023), PERS costs over and above current levels will have exceeded the new revenue generated by the tax. However, the tax isn't intended to help cities and counties. It will be a state-level tax. Absent PERS reform or a revenue package targeted to local governments, cities and counties would be left on their own to deal with skyrocketing PERS costs. This will force trade-offs with important services like police and fire protection and parks.

$2 Billion Revenue Package vs. PERS Cost Growth for K12, State Agencies, and Postsecondary Education. A more apt comparison may be of new revenue to PERS costs for schools, state agencies and postsecondary education, but excluding cities and counties. As Chart 4 below shows, school districts, ESDs, community colleges, state universities, and state agencies together will owe $680 million in additional PERS costs in 2019-21 and more than $1 billion on top of that the following biennium, for a total increase of more than $1.7 billion above current levels through 2021-2023. By 2029-2031, biennial PERS costs for these public employers will be more than $3 billion higher than they are today.

Compare this to a possible $2 billion revenue package. Even assuming a brisk 5% annual rate of growth for revenue, total state and school district costs will grow more quickly. By the 2021-23 biennium, state agency, school district and higher education PERS cost increases could amount to 78% of potential revenue increases, rising to 89% and 91% in the following two biennia, respectively.

Chart 4. Biennial PERS and Debt Service Costs Above Current Levels for State Agencies and Public Education Compared to Potential $2 Billion Revenue Package (Millions)



Source: OBC analysis of PERS Employer Projection Tool data, data provided by State Department of the Treasury for POB debt service costs, and 2019 LRO Public Finance: Basic Facts.

The Situation Could Get Significantly Worse With 2018 Market Returns

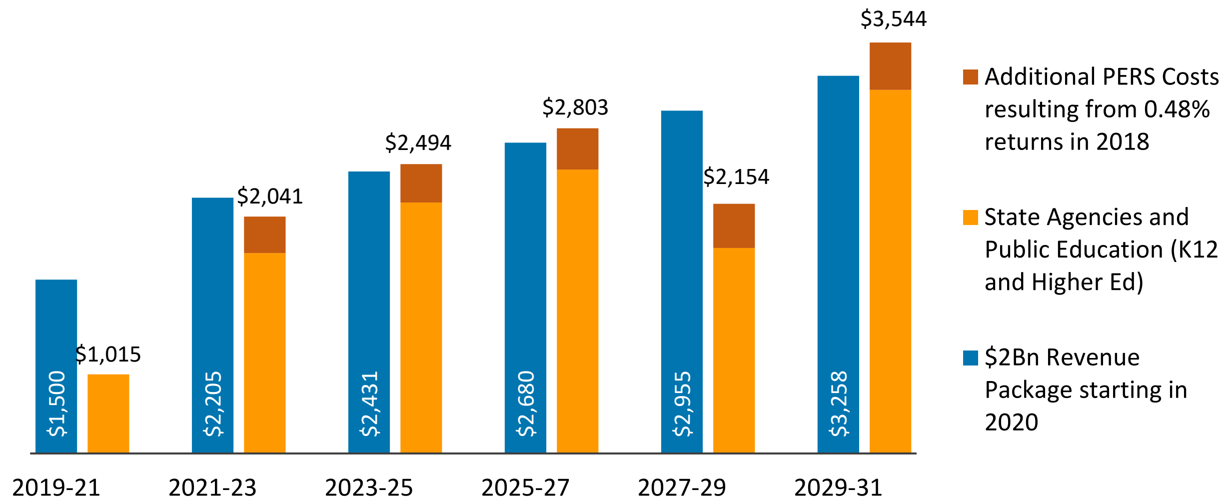
PERS actuary Milliman, at the Feb 2, 2019, PERS Board meeting, gave its initial readings of the PERS Fund's 2018 earnings. According to Milliman, the PERS fund performed well below the earnings assumption of 7.2%, which previous cost estimates were based on.[5] The initial earnings estimates for 2018 were 0.48%. But Milliman also warned that in the final analysis returns may have even dipped into negative territory.

If 2018 returns came in at 0.48%, but met the assumed earnings rate of 7.2% thereafter, then PERS costs beginning in 2021-23 may be 2.34 percentage points of payroll higher than previously anticipated.[6] This could

[4] The Legislative Revenue Office's 2019 Oregon Public Finance: Basic Facts report assumes that an economy-wide tax on business activity (either a gross receipts tax or value-added tax) would grow at roughly 5% per biennium.
[5] https://www.oregon.gov/pers/Documents/Board-Meetings/2019/Board%20Packet_2-1-2019.pdf
[6] The PERS Employer Projection Tool anticipates systemwide net rates of 22.8% in 2021-23. Milliman projects net rates of 25.2% for the same biennium in its February board packet.

add more than $300 million to state and school district costs in the 2021-23 biennium. When stacked against a potential $2 billion revenue package, the strain of PERS becomes even more evident. As shown in Chart 5, by the 2023-25 budget cycle, anticipated PERS increases for the state and public education could rise to more than 100% of new revenues raised.

Chart 5. Biennial PERS and Debt Service Costs for State Agencies and Public Education, Adjusted for 2018 Market Returns (Millions)

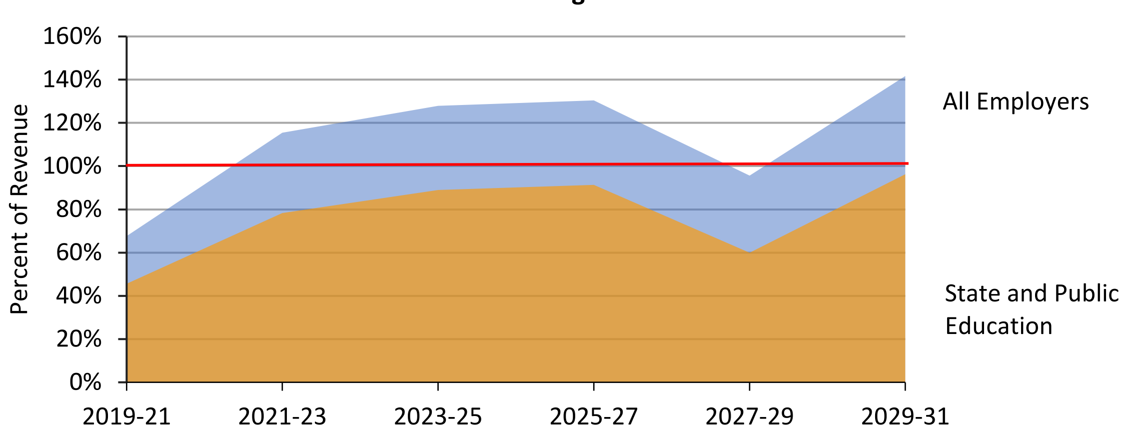


Source: OBC analysis of PERS Employer Projection Tool data, data provided by State Department of Treasury for POB debt service costs, data presented by Milliman at Feb. 2019 PERS Board Meeting, and LRO Public Finance: Basic Facts, 2019

Conclusion and Implications for Legislators

The state sorely needs strategic investments in its education system. However, commitments to fund Oregon's PERS system will make it difficult for the state to realize the intended value of that investment. As Chart 6 shows, cumulative PERS costs increases for all public employers through 2029-2031 will amount to 117% of the cumulative revenue generated by a $2 billion tax package over the same period. For state agencies and public education, the cumulative PERS cost increases will amount to 79.4% of the revenue generated by the tax. Reforms to PERS are needed to extend the value of new dollars and ensure that the intended benefit reaches Oregon students.

Chart 6. PERS Increases Above Current Levels as a Percent of $2 Billion Revenue Package



Source: OBC analysis of PERS Employer Projection Tool data, data provided by State Department of the Treasury for POB debt service costs, and 2019 LRO Public Finance: Basic Facts.

Note on Data and Methodology

Analysis and charts presented in this paper are based on the projected cost and revenue data shown in the table below. All charts present the total PERS-related charges public employers pay, which include both net rates and debt service costs for those employers with pension obligation bonds used to capitalize their side accounts. Charges from PERS rates are drawn from analysis of PERS Employer Projection Tool data and reflect updates PERS made to the tool in January, 2019.[7] Debt service for pension obligation bond costs were calculated from a spreadsheet acquired from the Department of Treasury in 2017. Revenue growth estimates were based on Legislative Revenue Office's 2019 Public Finance: Basic Facts report.

$2 Billion Revenue vs PERS Costs through 2030-31 (millions of $)					
	$2 Billion Added Revenue + 5% Per Year	PERS Costs Above Current Levels for All Entities	PERS for All Entities as a Percentage of Revenue	Pers Costs Above Current Levels for State and Education	PERS for State and Education as a Percentage of 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%
2027-29	$2,955	$2,825	95.6%	$1,773	60.0%
2029-31	$3,258	$4,616	141.7%	$3,136	96.3%
Total through 2029-31	$15,029	$17,607	117.2%	$11,932	79.4%

[7] https://www.oregon.gov/pers/EMP/Pages/Employer-Rate-Projection-Tool.aspx