Barbara Clark

11/90 PERS

The City of Portland's Participation in PERS: A Review of Costs and Benefits

November, 1990

Office of the City Auditor
Portland, Oregon

CITY OF
PORTLAND, OREGON
OFFICE OF CITY AUDITOR

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November 14, 1990

TO: J.E. Bud Clark, Mayor
Earl Blumenauer, Commissioner
Dick Bogle, Commissioner
Mike Lindberg, Commissioner

SUBJECT: Audit of the City of Portland's Participation in PERS

Attached is Audit Report #149 on the City of Portland's participation in the Oregon Public Employes Retirement System (PERS). The report evaluates the costs and benefits of retirement under PERS and the Social Security programs. The audit was conducted in accordance with our FY 1990-91 audit schedule. A summary of results is provided at the beginning of the report.

We have discussed this report with staff in the City's Office of Finance and Administration, Intergovernmental Affairs, and the State of Oregon's Public Employes Retirement System. Written responses are included at the back of the report.

We are hopeful that this report will give Council and the general public a better understanding of PERS, and provide useful information for decision-making.

We appreciate the cooperation and assistance we received from City staff, the Public Employes Retirement System, and the PERS actuary Milliman and Robertson, Inc.. Their assistance and advice aided us considerably in preparing this report.

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A Report by the Audit Services Division
Report #149

Office of the City Auditor
Portland, Oregon

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Summary

Employe benefits are a large and growing part of government costs. In FY 1989-90, the City of Portland spent over $72.8 million for health, dental and life insurance, retirement and disability, and other benefits for its employes. These costs are 31 percent of total employe compensation, up from 26 percent ten years ago. The Audit Services Division of the City Auditor's Office has reviewed several of these programs in past years including health costs and fire and police pension costs. This report evaluates the benefits and costs of retirement under the Oregon Public Employes Retirement System (PERS) and Social Security programs.

PERS Costs are Growing

Approximately 3,300 out of 4,600 City of Portland employes are covered by Oregon PERS and Social Security. The City and its employes make monthly contributions to these programs to fund retirement and disability benefits. PERS costs have nearly doubled since FY 1980-81, increasing from $9.0 million to almost $17.9 million in FY 1989-90. PERS adds almost 18 percent to a City employe's cost.

Several factors have contributed to PERS cost growth. Wage increases and new services have increased City payroll costs by almost 75 percent. Additionally, annexations in the mid-1980s added to City employment about 220

PERS covered police officers and firefighters, who require higher PERS contributions. Also, new benefit coverages such as retiree health supplements and earlier retirement were added by the Legislature. Other rate hikes were caused by actuarial adjustments for changing termination, death and disability rates.

City Retirees Earn High Retirement Benefits

The goal of PERS is to provide the same standard of living to retirees that they had before retirement. However, our analysis of City retirees over the past three years concluded that career employes will have more disposable income after retirement than before retirement. We estimate that retirement income for retirees at age 62 will range from 104 to 140 percent of pre-retirement income. Based on our analysis, retirees had an average retirement income from PERS and Social Security of approximately $35,500. Disposable income after retirement averaged $29,000 as compared to $25,000 before retirement.

City employes covered by PERS can have more disposable income retired than working because of PERS methods for determining benefits. Portland retirees have unused vacation and sick leave that significantly increase the salary base used to determine benefit amounts. However, even without these supplements, the PERS actuary estimates that most retired career employes will meet or exceed 100 percent of pre-retirement income at age 65.

While other Oregon public employers also allow employes to accrue unused sick leave and vacation, some employers cap accruals at a lower level than the City of Portland. Consequently, career employes from these jurisdictions should also earn more when retired than working, but not as much as Portland retirees.

Portland retirees do not appear to adjust their work habits during their final years of work to increase their PERS benefit. We found no patterns of increased overtime or reductions in sick leave or vacation use in the final three years of work. Most recent retirees used the same amount of vacation and sick leave, and earned the same level of overtime, as active employes in their job class.

Oregon PERS More Generous than Other State Systems

Our evaluation of 16 other state retirement systems of similar size and operation shows the Oregon system provides more opportunities for generous benefits. Although the basic formula provides benefits comparable to other systems, other states generally limit the addition of unused sick leave and vacation to benefit calculations. These supplements can make Oregon PERS benefits higher than other state systems.

Options for Controlling PERS Costs

The City has limited ability to control PERS costs. Costs are influenced by investment earnings, demographic changes, and benefit levels that are largely uncontrollable by PERS employers. Although PERS employers can place some limits on salary supplements, the Oregon Supreme Court has held that labor contracts also constrain these actions. As a result, pension benefits for current employes typically can be increased, but not decreased.

The growth in PERS costs is most effectively controlled by the State Legislature moderating enrichments to the existing program. The PERS Board and the Legislature should carefully review the adequacy of existing benefits before enriching the program with new coverages. The Legislature and PERS may also wish to evaluate existing goals for the PERS program to determine if they are met. The Legislature could consider establishing a new tier of PERS for new hires if the existing system cannot be modified.

To help moderate the costs of PERS, we make several recommendations on page 32.

Introduction

This report covers our audit of the City of Portland's experience with the Oregon State Public Employes Retirement System (PERS). The audit was conducted in accordance with generally accepted government auditing standards. The scope of our work is described in the Scope and Methodology section of this report.

City of Portland Employe Benefits

The City offers its employes a wide range of benefits including eight different health and dental packages, as well as three life insurance options. The City also participates in two separate disability and retirement programs for employes. The Fire and Police Disability and Retirement Plan (FPDRP) provides benefits to approximately 1,300 City police officers and firefighters, and the Oregon Public Employes Retirement System provides benefits to approximately 3,300 general service and certain police and fire employes. PERS covered employes are enrolled in the federal Social Security system, but FPDRP employes do not participate in Social Security.

In FY 1989-90, the City spent $235 million on salary and benefits for its approximately 4,600 full-time employes. Of this, $162.5 million was spent on wages, while the remaining $72.8 million was spent on benefits.

Table 1 City of Portland Compensation Costs:* FY 1980-81 through FY 1989-90

Fiscal Year	Salary	Benefits	Total	Benefits as % of Total
1980-81	$ 96,747,261	$ 34,576,936	$131,324,197	26%
1981-82	104,349,776	39,067,788	143,417,564	27%
1982-83	108,459,234	43,047,115	151,506,350	28%
1983-84	106,946,776	43,298,130	150,244,906	29%
1984-85	122,515,669	48,026,534	170,542,203	28%
1985-86	129,432,127	53,193,849	182,625,976	29%
1986-87	142,539,265	57,591,551	200,130,816	29%
1987-88	148,722,722	62,808,281	211,531,003	30%
1988-89	153,022,763	67,887,538	220,910,301	31%
1989-90	162,564,944	72,842,323	235,407,267	31%

* Includes retirement and disability costs associated with the City's Fire and Police Disability and Retirement Plan.

SOURCE: City of Portland accounting documents and financial statements for FY 1980-81 through FY 1989-90.

As shown in Table 1, over the past 10 years larger portions of employe costs have been devoted to providing employe benefits. These increases are primarily the result of cost increases in Social Security, other retirement benefits, and health care costs.

The Audit Services Division of the City Auditor's Office has reviewed several of these programs including health costs *(Containing the Cost of City Health Care Programs,* Report #IAR 2-86) and the costs of the City's Fire and Police Disability and Retirement Plan *(Review of the Fire and Police Disability and Retirement Plan,* Report #IAR 4-86). This report evaluates the benefits and costs of retirement under the Oregon Public Employes Retirement System and Social Security programs.

Audit Scope and Methodology

The objective of this audit was to evaluate the cost of PERS to the City of Portland and the adequacy of benefits for retirees. We also reviewed ways to control PERS costs.

In conducting the audit we reviewed budget documents, audit reports and studies, PERS annual reports and policy statements, City financial records, state and local laws governing retirement benefits, and actuarial studies and other information on PERS. We interviewed managers from the City of Portland's Office of Finance and Administration (including Administrative Services, Payroll, Computer Services, and Treasury), the Public Employes Retirement System, the State Division of Audits, and other public employers in Oregon who participate in PERS. We also interviewed the PERS consulting actuary from the firm of Milliman and Robertson, Inc. In addition, we interviewed benefits managers from several cities and counties with independent pension programs, and private sector employers in the Portland metro area.

We conducted a survey of 16 other state retirement systems to obtain information on their system and benefits. The 16 state systems we chose were similar in size and membership to Oregon PERS. They were Arizona, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Minnesota, Mississippi, New Jersey, South Carolina, Tennessee, Utah, Virginia, Washington, and Wisconsin. We also used information reported by the Fiscal Affairs Program of the

National Conference of State Legislatures and information compiled by the National Association of State Retirement Associations.

In order to evaluate whether City of Portland retirees are receiving adequate benefit amounts under PERS, we analyzed the retirement benefits of the 167 City of Portland employes who retired in 1987, 1988 and 1989. Specifically, we compared the pre- and post-retirement estimated income of the 65 who were career employes.

Appendix 1 provides a complete listing of organizations and jurisdictions contacted, and literature reviewed.

Chapter 1 Oregon's Public Employes Retirement System

Chapter Summary

The Public Employes Retirement System (PERS) is a defined benefit pension plan established in 1946 by the Oregon Legislature. Approximately 95 percent of all public employe jobs in Oregon are covered under PERS. Benefits are funded from member contributions, employer contributions, and earnings from investments. A goal of the plan is to provide career employes with the "same standard of living" after retirement as enjoyed immediately before retirement.

Public Employes Retirement System Description

The Public Employes Retirement System was established in 1946 by the Oregon Legislature to enable public employers in Oregon to provide their employes with secure retirement benefits. It is a defined benefit pension plan which provides comprehensive retirement, disability, death and post-retirement health insurance benefits to its members. As such, it pays specific benefits based on such factors as age, length of service, and salary. A nine member board of trustees administers the system. Plan design and benefit options are established by state law.

All public employers are eligible to participate in PERS. Employers may not withdraw covered employes once they have been enrolled. Currently, approximately 95 percent of all public employe jobs in Oregon are covered under

PERS. Those public employers not participating in PERS participate in other pension programs.

In 1988, PERS had investments and other assets of over $9.7 billion, and reported $1.8 billion in revenues and over $359 million in expenditures, mostly benefits.

PERS Retirement Goals and Benefits

The goal of PERS is to provide career employes with the "same standard of living" after retirement as enjoyed immediately before retirement. PERS anticipates that a career employe who is eligible for full benefits should have a disposable income from PERS and Social Security that is equal to his or her disposable income before retirement. Periodic benefit increases have been granted to ensure that members maintain purchasing power after retirement. On average, public safety and male general service retirees receive benefits for 18 to 20 years after retirement, living until approximately 80 years of age. Female general service employes generally live approximately 5 years longer.

General service employes may retire after reaching age 55, while police and fire employes may retire at 50. However, these employes must have 30 or 25 years of service, respectively, to be entitled to full benefits. Employes may also retire at any age with full benefits if they have at least 30 years of service. Employes who retire early receive a reduction in their benefits. PERS states that employes who retire early should supplement their retirement with other income or savings.

Benefits are calculated using three factors: the employe's final average salary, the number of years of service, and a factor which is set by state statute at 1.67 percent for general service employes and 2.00 percent for legislators, police and fire employes. Final average salary is either the average of the last 36 consecutive months earnings, or the monthly average of the three highest calendar year earnings. Earnings include straight hourly wages, premium pay, overtime, and any vacation lump sum payment made when the employe retires. In addition, the value of half of any unused sick leave is included in the calculation of final average salary. Table 2 illustrates how this method works for a general service employe with a final average monthly salary of $3,000 and 30 years of service, and a public safety employe with a final average monthly salary of $3,000 and 25 years of service.

Table 2 PERS Benefit Calculation Example (Full-Formula Method)

	Final Average Salary	X	Multiplier	X	Years of Service	=	Retirement Benefits
General Service	$3,000	X	.0167	X	30 years	=	$1,503 per month
Public Safety	$3,000	X	.02	X	25 years	=	$1,500 per month

SOURCE: Audit Services Division analysis.

PERS can also use two other methods to calculate an employe's retirement benefits. The method producing the highest amount is used by PERS to determine the employe's monthly benefit.

Retirees have the choice of twelve different payment options, which result in different monthly benefits.

Monthly payments will be higher if no provision is made for payments to survivors when the retiree dies, and monthly payments will be lower if a lump sum is taken at retirement. However, all payments have the same actuarial value. For example, a retiree who receives a monthly benefit of $2,050 without a survivorship benefit might receive $1,599 if a full survivorship payment option was selected.

How PERS Is Funded

Benefits paid by PERS are funded from three sources: employer contributions, member contributions, and earnings from investments. Member contributions are set by state statute at 6 percent of salary. Most PERS employers, including the City of Portland, "pick-up" the employe's contribution and remit it to PERS on the employe's behalf. Members are not currently taxed on pick-up portions.

Employer contribution rates are evaluated by an actuary every two years. Rates may be adjusted to cover expected costs of retirements. Costs can change due to shifting demographics such as longer life expectancy, fewer terminations from service, or increased disability rates. Also, assumptions about the future rates of inflation on benefits may require rate changes. Legislative increases in the types of benefits provided by PERS can also increase employer rates. When factors differ among employers, contribution rates vary. For example, because public safety employes may retire earlier, their benefits cost more to fund. Consequently, an employer with a higher proportion of public safety employes will have higher PERS costs.

Investments are an important part of PERS funding. If PERS investment earnings are not adequate to pay the defined benefits, employer costs will increase to make up the difference. During the past decade, PERS investments have been very profitable with a rate of return ranging from 4.37 percent to 22.70 percent per year, averaging 14.69 percent. Investment earnings have moderated employer contribution rates.

Social Security Funding

Employes enrolled in PERS can choose between full Social Security benefits at age 65, or 80 percent of benefits at age 62. Currently, the employer and the employe each contribute 7.65 percent of salary to fund Social Security benefits.

Chapter 2 City of Portland PERS Costs

Chapter Summary

Approximately 3,300 out of 4,600 City of Portland employes are covered by PERS and Social Security. PERS costs have nearly doubled since FY 1980-81, increasing from $9.0 million to almost $17.9 million in FY 1989-90. The addition of public safety employes, changing employe demographics, legislated benefit enhancements, and rising wages have all contributed to growing PERS costs.

Portland PERS Costs

The City of Portland PERS costs have risen steadily over the past 10 years. Since 1980-81, the required City contribution rate has increased from 10.49 percent of PERS covered payroll to 12.92 percent in 1989. In January 1990, the City's rate dropped to 11.81 percent. Table 3 shows the City's PERS rates and costs over the last 10 years.

Table 3 illustrates only those costs associated with the approximately 3,300 employes covered by PERS. Approximately 1,300 fire and police employes are covered under the City of Portland Fire and Police Disability and Retirement Plan, which is funded with a separate tax levy. In FY 1989-90, the Fire and Police Disability and Retirement Fund had expenditures of over $30 million, $20 million of which covered retirement benefits. State law requires that the City's plan for sworn police and fire employes be "equal-to-or-better-than" PERS. Therefore, changes to PERS can also affect the City's independent pension plan.

Table 3 **City of Portland PERS Costs: FY 1980-81 through FY 1989-90**

Fiscal Year	PERS Payroll	Employer Rate*	Employer Amount	6% Employe Contribution**	Total PERS Cost
1980-81	$55,407,000	10.49/9.96%	$5,666,000	$3,324,000	$ 8,990,000
1981-82	62,682,000	9.96%	6,243,000	3,761,000	10,004,000
1982-83	67,670,000	9.96/10.27%	6,845,000	4,060,000	10,905,000
1983-84	65,377,000	10.27/9.22%	6,371,000	3,923,000	10,294,000
1984-85	75,835,000	9.22%	6,992,000	4,550,000	11,542,000
1985-86	81,171,000	9.22%	7,484,000	4,870,000	12,354,000
1986-87	86,030,000	9.22%	7,932,000	5,162,000	13,094,000
1987-88	93,018,000	9.22/12.92%	10,297,000	5,581,000	15,878,000
1988-89	94,623,000	12.92%	12,225,000	5,677,000	17,902,000
1989-90	97,241,000	12.91/11.81%	12,024,000	5,834,000	17,858,000

* In some years, two different rates were applied.

** Paid by City beginning in FY 1980-81 in lieu of a wage increase.

SOURCE: City of Portland Comprehensive Annual Financial Reports FY 1980-81 to FY 1989-90 and payroll information.

Factors Affecting PERS Costs

There are a number of factors that both increase and decrease the City's PERS costs. Because PERS estimates costs to cover sworn police and fire employes to be almost twice that of general service employes, the City experienced a substantial increase in its rate with the addition of approximately 220 sworn police and fire employes. These sworn employees were transferred to the City through annexations and intergovernmental agreements with

Multnomah Rural Fire Protection District 10, Clackamas Rural Fire Protection District 1, and Multnomah County. It is anticipated that once these more costly employes retire, the portion of the rates affected by this will be adjusted downward.

Legislative enhancements to PERS benefits have also increased PERS costs for the City. "Ad hoc" increases to adjust benefits to meet inflation affected rates in 1980, 1983, and 1986. Additionally, new enhancements affected rates in the 1980s:

- The option of allowing employes to convert one-half of their unused sick leave to final salary base;
- benefit increases for early retirees; and
- employer subsidized retiree medical insurance.

An action which may be expected to increase employer contributions to PERS is the state's response to *Davis v. Michigan,* in which the U.S. Supreme Court ruled that federal and state retirees may not be taxed differently by the state.

Cost increases and decreases have also occurred as a result of various demographic changes in the work force of the City and other PERS employers that require actuarial adjustments. For example, more disability claims, fewer deaths, and fewer terminations prior to retirement resulted in more costs and higher contribution rates. Conversely, better investment returns and slower salary increases lowered costs and moderated rate hikes.

Finally, wage increases also increase dollar costs because PERS costs are determined as a percent of payroll. The PERS covered payroll increased over 75 percent in the 10 year period shown in Table 3, making wage increases a large contributing factor to increased PERS costs.

Chapter 3 City Retirees Earn High Retirement Benefits

Chapter Summary

The goal of Oregon's PERS is to provide retirement benefits to career employes which equal but do not exceed 100 percent of the employe's pre-retirement standard of living. However, based on an analysis of City retirees over the past three years, we conclude that career employes retiring from the City have more disposable income after retirement than when working. We estimate that these retirees had an average annual retirement income from PERS and Social Security of approximately $35,500. Disposable income after retirement averaged $29,000 -- 19 percent above their pre-retirement disposable income.

Retirees are able to exceed PERS benefit goals primarily because Oregon law allows an employe's final salary base to include overtime pay and be supplemented with unused sick leave and vacation compensation. Portland retirees have significant amounts of accrued sick leave and vacation time, increasing the salary base upon which retirement benefits are determined. Most other Oregon public employers participating in PERS also allow employes to increase retirement benefits with unused sick and vacation time, but some of the employers we surveyed cap these amounts at lower levels than the City of Portland.

We did not find that City employes adjust their work habits in the last years of work to increase final average salary and retirement benefits. Our tests did not show any consistent patterns of increased overtime or reduced sick leave and vacation time by employes nearing retirement.

PERS Benefit Adequacy Goals

The PERS Board of Trustees developed revised goals and objectives for the System in November 1986. These goals and objectives are intended to provide guidance for the administration of the system and its benefit levels. The Board stated that retirement security is the responsibility of both the employe and employer, and the importance of adequate retirement to a career employe must be balanced with the cost of providing the benefit. In order to offset prohibitive costs of providing benefits, federal Social Security retirement income must be taken into account when setting the level of PERS benefits. The Board stated:

> The standard of living provided by the combination of an employe's primary federal social security benefit and the benefit paid from the retirement system should not exceed 100 percent of the employe's standard of living at retirement.
>
> The system's retirement benefit for a career employe currently leaving the work force at age 62, when added to social security benefits, should provide the same standard of living immediately after retirement as enjoyed immediately before retirement.

"Standard of living" is defined as disposable income. For the working employe, disposable income is compensation, less taxes, contributions to the retirement plan and to Social Security, and other work related expenses. For the retiree, disposable income is compensation from PERS and Social Security, less taxes and health insurance. A "career employe" is a person with 30 or more years of general service, or 25 or more years of public safety service.

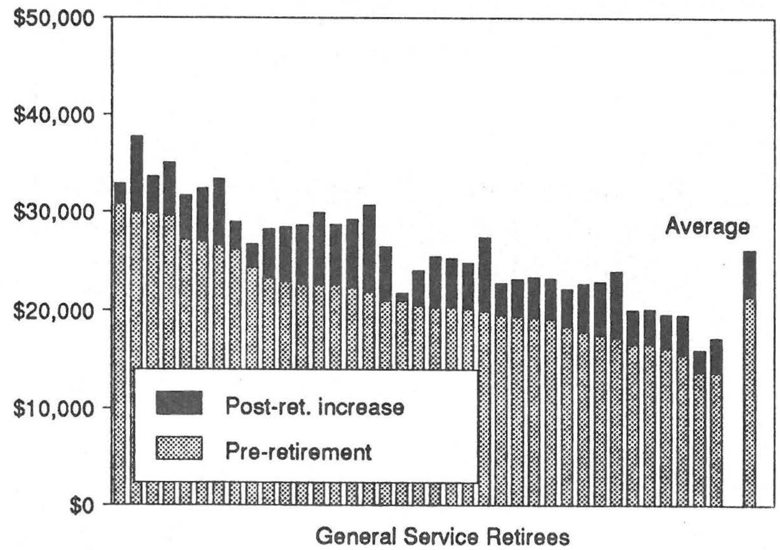
To ensure PERS benefits meet the goal, the Board periodically has a Benefit Adequacy Study performed by a consulting actuary. The most recent study was released in August 1990.

Portland PERS Retirees Exceed Benefit Goals

To evaluate the adequacy of retirement benefits for recent City of Portland retirees, we obtained retirement data on all employes retiring from the City in 1987, 1988 and 1989. Of 167 total retirees, 65 were career employes -- 37 general service employes and 28 fire employes. There were no PERS police retirees in those years. We obtained compensation and benefit information from the City's Office of Finance and Administration and from PERS, and we compared estimated disposable income immediately before retirement to PERS and expected Social Security benefits. We employed the same comparison method used by the PERS actuarial firm, Milliman and Robertson, Inc., to assess benefit adequacy. Appendix 2 provides an explanation of our methodology.

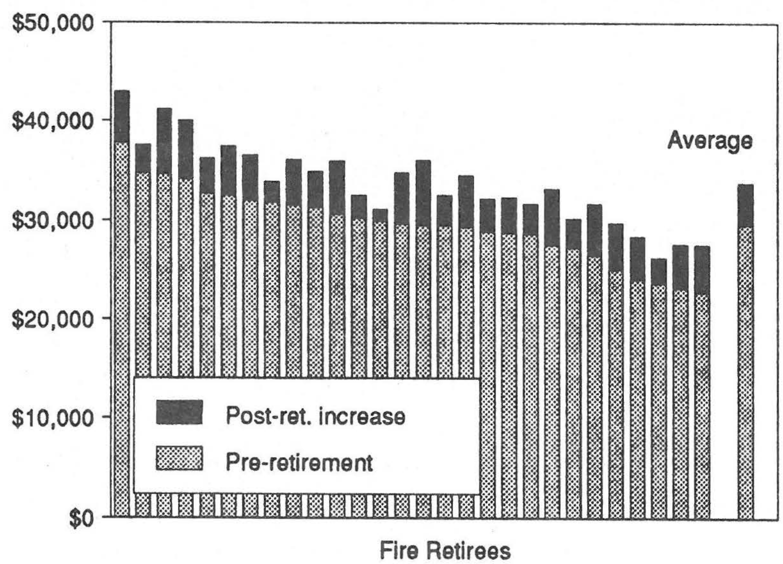
We conclude from our analysis that disposable income from retirement benefits for all 65 career employes exceed their disposable income before retirement. Retirement benefits before taxes ranged from $18,000 to $54,000, averaging $35,500. Disposable retirement income ranged from $16,000 to $43,000 per year, averaging $29,000 annually. In comparison, pre-retirement gross income ranged from $20,500 to $70,700, while disposable incomes ranged from $14,000 to $38,000 annually, averaging $25,000. Disposable retirement income range from 104 percent to 140 percent of pre-retirement disposable income, averaging 119 percent. Figures 1 & 2 compare the pre- and post-retirement disposable income for the 37 general service and 28 fire career employes.

Figure 1 Disposable Income: General Service Retirees



SOURCE: Audit Services Division analysis.

Figure 2 Disposable Income: Fire Retirees



SOURCE: Audit Services Division analysis.

Reasons for High Retirement Benefits

Portland retirees are able to receive more when retired than when working due to three major factors. First, PERS law allows significant supplements to the salary base used to calculate monthly retirement benefits. Supplements can include all overtime pay, plus half the value of all unused sick leave hours, and lump sum payments for unused vacation. We found that general service retirees averaged 1,457 hours of unused sick leave, 478 hours of unused vacation, and 120 hours of paid overtime. Fire employes averaged 1,697 hours of unused sick leave, 1,034 hours of unused vacation, and 568 hours of paid overtime. Table 4 shows how these supplements can increase the average PERS retirement benefits for employes.

Table 4 **Average Increase in Portland Retirees' Benefits From Salary Supplements**

	General Service Retirees	Fire Retirees
Average base salary	$33,912	$46,716
Average supplement hours		
Sick *	1,457 hrs	1,697 hrs
Vacation	478 hrs	1,034 hrs
Overtime	120 hrs	568 hrs
Base salary plus supplements	$41,868	$62,376
Benefit (from base salary only)	$19,068	$24,588
Benefit (from base plus supplements)	$23,544	$32,832
Increase	$4,476 (+23%)	$8,244 (+34%)

* Total unused sick leave hours; 50% of total allowed as supplement

SOURCE: Audit Services Division analysis.

Appendix 3 provides additional explanation on the effect that salary supplements have on retiree benefits.

Second, each additional year of service beyond 30 years for general service and 25 years for police and fire increases PERS retirement benefits 3 to 4 percent. Our 65 career employes averaged almost 34 years of service for general service employes and 27 years for fire employes. Length of service for all 167 Portland retirees in 1987, 1988 and 1989 averaged 22 years, higher than the statewide PERS average of 18 years of service.

Third, even without significant supplements to final average salary or additional years of service, Oregon law would make disposable income from combined PERS and Social Security benefits for retirees equal to, or over, 100 percent of their pre-retirement disposable income when they begin receiving social security at age 65. We base this conclusion on the August 17, 1990 Benefit Adequacy Study prepared for PERS by the actuarial firm of Milliman and Robertson, Inc.

Milliman and Robertson reviewed the adequacy of retirement benefits provided to general and public safety employes to determine if they would meet benefit goals established by PERS. Table 5 shows their results for general service employes and public safety employes.

Table 5 **Adequacy Ratios of Career Employes (Combined PERS and Social Security Benefits)**

Wage Level	General Service Employe PERS and Social Security at age 65	Public Safety Employe PERS and Social Security at age 65
$20,000	131%	128%
$30,000	125%	123%
$40,000	119%	118%
$50,000	112%	111%

SOURCE: Milliman and Robertson, Inc. *Adequacy of Retirement Income - 1990,* August 1990.

Fifty of the 65 career employes in our city (77 percent) retired before they could receive Social Security. For these employes, income from savings or other employment are required to maintain the same standard of living before Social Security benefits commence. Employes enrolled in PERS can choose between full Social Security benefits at age 65, or 80 percent of benefits at age 62.

Use of Supplements by Other Oregon PERS Employers

We found that other public employers in Oregon permit employes to use accrued sick leave and vacation pay, to supplement PERS retirement benefits. PERS officials told us that almost all school districts, all but five counties, and most large cities participate in the sick leave conversion option. Accordingly, these career employes can also increase their retirement standard of living depending on the degree to which they can accrue unused sick leave and vacation.

Our survey of large Oregon public employers showed that some employers place more limits on the amount of sick and vacation leave that can be accrued. As shown in Table 6, Portland general service employes can apply unlimited sick leave hours and up to 400 vacation hours to retirement calculations, but some other employers cap these accruals at lower levels. Consequently, employes in these other jurisdictions will also earn retirement benefits

Table 6 Comparison of Portland Sick Leave and Vacation Accrual Practices to other Regional Employers

Employer	Maximum Vacation Accrual	Maximum Sick Leave Accrual
Clackamas Co.	280 hours	unlimited
Lane Co.	Combines both vacation and sick hours. Limited to between 328 and 376 hours at retirement	
Multnomah Co.	400 hours	unlimited
Washington Co.	360 hours	unlimited
State of Oregon	250 hours	unlimited
City of Eugene	576 hours	960 hours
City of Portland	Gen. Svc: 400 hours Fire: 816 hours Police: 400 hours	Gen. Svc: unlimited Fire: 2735 hours Police: 2064 hours

SOURCE: Audit Services Division survey of other PERS employers.

in excess of their pre-retirement disposable income, but not as much as Portland retirees.

In actual practice, we found that a City Code provision allows employes to cash out more unused vacation time than the established accrual limits of 400 hours for general service and 816 hours for fire employes. The City reduces accrued vacation to the two year maximum each January, but allows more accruals to be applied until the following January. As a consequence, general service employes may actually accrue up to 600 hours and fire employes up to 1224 hours. If an employe retires in December, three years of vacation pay can be cashed-out and applied to PERS final average salary calculation. In our sample, 29 of the 37 general service employes had over 400 vacation hours at retirement, and 24 of the 28 fire employes had over 816 vacation hours at retirement.

Employe Work Habits in Final Years of Employment

Because retirement benefits are based on the highest 3 years of earnings, or the final 36 months of earnings, employes have an incentive to increase overtime and other pay, and reduce sick leave and vacation usage in the final years of employment. To assess whether employes changed their work habits in these years to increase final salary calculations and retirement benefits, we reviewed the payroll history of all active and retired employes in the years 1987, 1988 and 1989.

We found no difference in the amount of overtime earned by retirees in their final three years compared to the amount earned by active employes in the same job classes. We found that employes close to retirement sometimes worked more overtime than actives, and sometimes they worked less. Although some retirees had higher overtime earnings than other actives, this may be the result of seniority rather than any use of overtime to increase retirement benefits. The data also did not show any pattern of increasing overtime by employes during their last several years of service.

We also found no consistent patterns in how employes close to retirement use sick and vacation leave in comparison to active employes, or in how these employes use this leave during the last few years of service. In some years, firefighters close to retirement used leave at lower levels than other firefighters, but in general the average leave used was slightly greater. Also, most of the retirees appeared to use sick and vacation leave at the same rate in their final years of work as in the years outside the retirement calculation.

Chapter 4 Comparison of Oregon to Other State PERS Systems

Chapter Summary

Our evaluation of 16 other public employe retirement systems of similar size and operation shows that the Oregon system can provide more benefits than any of the other systems. Although the basic Oregon PERS formula provides an average benefit compared to other state systems, the ability to add vacation leave and half of all unused sick leave to benefit calculations increases Oregon PERS benefits beyond any of the other systems.

Other State Systems

State pension systems vary in such elements as the contribution rates, vesting and retirement age requirements, and benefit formulas. We compared Oregon PERS to pension systems in 16 other states: Arizona, Illinois, Indiana, Iowa, Kansas, Kentucky, Maryland, Minnesota, Mississippi, New Jersey, South Carolina, Tennessee, Utah, Virginia, Washington, and Wisconsin. These states were chosen because they are similar in size, operation, and membership composition to PERS. We found that although the basic benefit calculation formulas are similar, there are aspects of Oregon PERS which can make it more generous than any of the other state systems reviewed.

In order to determine what an employe would receive under each system, we calculated what a general service employe with 30 years of service making $30,000 would receive using each system's benefit rules. We also compared what a $30,000 employe with 30 years of service would receive under each system when sick leave accrual, vacation cash-outs, and overtime pay are included in benefit amounts. We found that although the basic Oregon PERS formula provides a benefit comparable to the average of other state systems, the ability to add unused sick leave and vacation to benefit calculations increases Oregon PERS benefits higher than others. Although 10 of the states we contacted indicated that they allow sick and/or vacation time to be added in to increase retirement benefits, supplements do not enrich other systems as much as they do Oregon's. Only four state systems exclude overtime pay in the calculation of benefits. Table 7 compares Oregon PERS to other state systems.

The state systems we analyzed use different benefit formula multipliers, final average salary calculations, and some limits on benefit amounts. All of these factors affect benefit amounts paid to retirees. Appendix 4 compares various benefit components of each of the state systems in our survey.

Table 7 Effect of Supplements on Annual Benefits: Oregon PERS and Other State Systems (excludes Social Security)

30 year General Service employe
$30,000 final year salary

				Portland Retiree Averages		Portland Retiree Maximums	
0 sick hrs 0 vac. hrs 0 O.T. hrs		1,000 sick hrs 200 vac. hrs 60 O.T. hrs		1,457 sick hrs 478 vac. hrs 120 O.T. hrs		1,854 sick hrs 600 vac. hrs 376 O.T. hrs	
Ariz.	$17,317	Ariz.	$18,066	Ariz.	$18,815	**ORE.**	**$22,703**
Utah	17,317	Utah	18,066	Utah	18,815	Ariz.	22,008
Ky.	16,668	Ky.	17,677	**ORE.**	**18,782**	Utah	22,008
Wash.	16,668	Wash.	17,389	Ky.	18,533	Ky.	21,812
S.C.	15,758	S.C.	16,945	Wash.	18,110	Wash.	21,183
Miss.	14,864	**ORE.**	**16,794**	S.C.	18,031	S.C.	20,936
N.J.	14,459	Miss.	15,588	Miss.	15,755	Wis.	17,776
ORE.	**14,459**	Iowa	14,520	Wis.	15,167	Iowa	17,688
Iowa	13,917	Wis.	14,499	Iowa	15,122	Tenn.	17,067
Wis.	13,853	N.J.	14,459	N.J.	14,459	Kans.	16,714
Vir.	13,692	Vir.	13,692	Tenn.	14,405	Miss.	15,863
Tenn.	12,830	Tenn.	13,658	Kans.	14,347	N.J.	14,459
Kans.	11,892	Kans.	13,435	Vir.	13,692	Minn.	14,122
Minn.	11,112	Minn.	11,593	Minn.	12,073	Vir.	13,692
Ill.	9,626	Ill.	10,734	Ill.	11,477	Ill.	13,569
Mary.	9,480	Mary.	9,663	Ind.	9,961	Ind.	11,652
Ind.	9,167	Ind.	9,564	Mary.	9,774	Mary.	9,853
AVE.*	$13,664		$14,344		$14,909		$16,900

* without Oregon

SOURCE: Audit Services survey and analysis.

Chapter 5 Options for Controlling PERS Costs

Chapter Summary

The City of Portland has limited ability to control its PERS costs. Many factors that affect costs, such as investment earnings and demographic changes, are beyond City control. In addition, reducing costs through benefits limitations is constrained by case law and labor contracts, and may not have a cost impact for 10 to 15 years.

PERS costs are controlled most effectively at the state level. Specifically, the State Legislature has authority to set benefit levels and establish the type of services provided by PERS. Controlling enrichments to the program and complying with goals for retirement income adequacy may moderate PERS cost increases. Also, a new program for new hires could be established.

Limited Ability to Reduce PERS Costs

The level of retirement benefits and services provided by PERS is just one of the factors that contributes to PERS costs. As discussed in Chapter 2, the cost of PERS is influenced by a variety of factors. For example, high earnings on PERS investments can reduce employer contribution rates. Conversely, longer life expectancy for retirees and their beneficiaries can increase costs. The City of Portland and other PERS employers have little control over such factors.

Employers also have limited ability to control costs by reducing benefits. Employe compensation and benefits for most employes are governed by the provisions of public employe labor contracts. According to state and federal collective bargaining laws, labor contracts cannot be changed without negotiations between the affected parties. For example, the City cannot unilaterally reduce the amount of unused vacation that can be accrued by employes represented by labor unions. If labor and management could agree to reduce the number of vacation hours that are cashed out, the effect on PERS contribution rates still would not be felt for 10 to 15 years.

Oregon follows the rule that retirement benefits are a part of an employe's promised but delayed compensation for job performance. In *Taylor v. Multnomah Deputy Sheriff Retirement Board 265 Or 445.510 P2d 339 (1973),* the Oregon Supreme Court found that retirement benefits become a contractual right of employes that cannot be reduced by a second plan put into effect later. According to the Portland City Attorney's office, this rule means that existing benefits can be increased, but not decreased.

New hires, however, are not affected by this rule. A new retirement program with revised benefits can be established for these employes. Although Oregon has only one PERS program, several states, including Washington and Maryland, have established tiers of PERS programs for employes hired at different times. Generally, the newer PERS programs have modified benefits to control escalating employer costs.

Controlling PERS Benefits

The costs of the existing PERS program can be most effectively controlled by the State Legislature. The Legislature can increase benefit levels, enrich PERS services to employes, and moderate enhancements to slow cost growth. The Legislature should carefully evaluate new services that will increase employer contribution costs. The 1990 Benefit Adequacy Study by the PERS actuary has found that retirees at age 65 should be able to maintain the same standard of living which they had immediately before retirement. Benefit enhancements for these retirees will improve retirement disposable income.

Moreover, if employes from other Oregon PERS jurisdictions are able to supplement their final average salary as do Portland retirees, PERS employes state-wide could have more disposable income when retired than when working.

The Legislature and PERS may wish to evaluate the goals and objectives of the system to see the degree to which they are met. We conclude that Portland's career employes exceed the goals. Although we did not specifically analyze the retirement benefits of employes without career service, it is likely that some of these employes will also meet or exceed the PERS goals. PERS, however, intends that early retirees will not earn full benefits but supplement income with savings or other income.

If benefits are exceeding PERS goals, adjustments may be needed. However, changes that affect members' benefits may be difficult given Oregon court case decisions. A second retirement system for all new hires may be an option for bringing PERS benefits in line with the PERS goal as well as containing retirement costs. A new retirement system could be designed to limit salary supplement amounts, extend the final average salary calculation from three to five years, or modify the multiplier used in the benefit formula. All of these changes could potentially bring PERS benefits in line with PERS goals. Other types of retirement plans, such as a defined contribution plan which provides benefits based on specific amounts contributed to a member's account, could be explored as another way to contain costs.

Recommendations

In order to moderate the rise in PERS costs, we recommend:

1. The City's Office of Intergovernmental Affairs should continue to place high priority on reviewing any legislation that affects PERS costs. The Office should inform the Oregon State Legislature on the impact of legislation, and urge moderation in benefit enhancements. The Office may wish to provide copies of this report to selected legislators and committees to demonstrate Portland's experience with PERS.

   In addition, the City may wish to request a more thorough review by PERS of the accomplishment of PERS goals and objectives. Depending on the outcome of this study, a second system of PERS for new hires could be considered.

2. The City's Office of Finance and Administration should evaluate the feasibility of limiting the number of sick leave hours that can be converted to retirement benefits and the number of unused vacation hours that can be cashed out at retirement. The Office may wish to make this a negotiable item in bargaining with public employe unions.

Appendix 1 Organizations Contacted and Literature Reviewed

Organizations and Authorities

State of Arizona

State of Colorado

State of Illinois

State of Indiana

State of Iowa

State of Kansas

State of Kentucky

State of Maryland

State of Minnesota

State of Mississippi

State of New Jersey

State of South Carolina

State of Tennessee

State of Utah

State of Virginia

State of Washington

State of Wisconsin

Oregon State Division of Audits

Oregon PERS

Milliman and Robertson, Inc.

City of Milwaukee, Wisconsin

Milwaukee County, Wisconsin

Kaiser-Permanente

Tektronix

Portland General Electric

Standard Insurance

Lane County, Oregon

Multnomah County, Oregon

City of Eugene, Oregon

Washington County, Oregon

Clackamas County, Oregon

Oregon State Employes Benefit Board

Oregon Legislative Fiscal Office

Oregon Labor Relations Division

Oregon Department of Justice

In addition to the above organizations, we contacted individuals within the City of Portland including staff from Intergovernmental Affairs, Treasury, Accounting and Payroll, Fire and Police Disability and Retirement Board, Budget, Employe Benefits, City Attorney Office, and Computer Services.

Publications

Audits of Employe Benefit Plans, by the American Institute of Certified Public Accountants (1983)

Comparative Statistics of Major State Retirement Systems, 1984-1988, by the Fiscal Affairs Program of the National Conference of State Legislatures (1989)

Oregon Public Employes Retirement System Benefit Adequacy Study, by Milliman and Robertson, Inc. (1986)

Oregon Public Employes Retirement System Benefit Adequacy Study, by Milliman and Robertson, Inc. (1990)

Oregon Public Employes Retirement System Comprehensive Annual Financial Report, by the Oregon Public Employes Retirement System (1987)

Oregon Public Employes Retirement System Comprehensive Annual Financial Report, by the Oregon Public Employes Retirement System (1988)

Member's Handbook: Your Membership and How It Works For You 1990-91, by the Oregon Public Employes Retirement System

State Pension Systems Survey by the National Association of State Retirement Associations (1988)

"An Alternative to Escalating Pension Costs", *Government Finance Review,* by Gary S. Clinton (October 1989)

Containing the Cost of City Health Care Programs, Office of the City Auditor, City of Portland, Oregon, Report IAR 2-86 (September 1986)

Review of the Fire and Police Disability and Retirement Plan, Office of the City Auditor, City of Portland, Oregon, Report IAR 4-86 (December 1986)

Appendix 2 Retirement Benefit Adequacy Methodology

In order to determine whether City retirees were meeting the PERS goal of "same standard of living", we estimated and compared pre- and post-retirement disposable income of 65 City of Portland career employes who retired with full benefits in 1987, 1988, and 1989. We followed the methodology of the PERS consulting actuary, Milliman and Robertson, Inc. with a few modifications. Our analysis was based on the retirees' actual earnings before retirement, Option 1 PERS benefit amounts, and estimated Social Security benefits at age 62. The following is a brief discussion of our methodology.

We estimated the benefit adequacy ratio of 65 City of Portland retirees. The "adequacy ratio" is the ratio of post-retirement disposable income to pre-retirement disposable income. An adequacy ratio of 100 percent means that a retiree should be able to maintain the same standard of living after retirement as he/she enjoyed while working. Retirees who have adequacy ratios above 100 percent can be said to have a higher standard of living after retirement. Those with ratios below 100 percent are not able to maintain the same standard of living in retirement.

Table 8 illustrates how we estimated disposable income. It should be noted that our analysis updated information (such as federal tax amounts) from the 1986 and 1990 Milliman and Robertson, Inc. studies. Table 8 calcu-

Table 8 Benefit Adequacy Ratio Analysis Example

Pre-retirement Income		
Gross Wages		$32,639
Deductions		
6% PERS Contribution	1,848	
Social Security tax	2,312	
Federal income tax	4,778	
Oregon income tax	2,172	
Work-related expenses	1,292	($12,402)
Pre-retirement disposable income		$20,237
Post-retirement Income		
Gross Income		$29,404
PERS (option 1)	21,033	
Social Security	8,371	
Deductions		
Federal income tax	3,224	
Oregon income tax	0	
Health insurance*	1,329	($4,553)
Post-retirement disposable income		$24,851
Adequacy Ratio		**123%**

* Although the 1990 Benefit Adequacy Study does not include a deduction for health insurance, we have included a $111/month insurance premium cost.

SOURCE: Audit Services Division analysis.

lates the pre- and post-retirement disposable income of a general service employe who retired in 1989.

Our analysis indicates that the retirement benefits of all 65 career employees who retired in 1987, 1988 and 1989 exceed their disposable income before retirement. Using the previously described methodology, Table 9 illustrates each employe's gross wages the year of retirement, pre-retirement disposable income, gross retirement benefits from PERS (Option 1) and Social Security at age 62, post-retirement disposable income, and the benefit adequacy ratio.

Benefit adequacy ratios for employes with similar pre-retirement gross incomes may vary. This is because of the effect that salary supplements, particularly sick leave, and other factors, such as increased years of service, have on benefit levels.

Other factors which contribute to increases in final average salary can also affect benefit levels, post-retirement disposable income, and the benefit adequacy ratio. In addition, tax rates based on the years of retirement may also affect post-retirement income levels.

General service and fire employees are listed separately.

Table 9 Estimated Incomes and Adequacy Ratios of Career Employes

	PRE-RETIREMENT		POST-RETIREMENT		Adequacy
	Gross*	Disposable	Gross	Disposable	Ratio
General Service	$37,114	$21,943	$37,278	$30,735	140%
	26,935	17,284	27,733	23,953	139%
	32,396	19,972	32,512	27,430	137%
	38,734	22,637	36,185	29,964	132%
	36,916	22,338	35,483	29,249	131%
	27,805	17,572	26,485	22,915	130%
	28,435	17,882	26,313	22,773	127%
	37,500	22,625	34,710	28,701	127%
	37,621	22,689	34,649	28,654	126%
	34,975	21,010	31,365	26,474	126%
	23,778	15,577	21,954	19,576	126%
	54,590	30,026	46,940	37,709	126%
	20,540	13,743	19,311	17,256	126%
	47,850	26,676	40,913	33,376	125%
	33,485	20,378	29,921	25,450	125%
	33,193	20,365	30,019	25,298	124%
	39,366	22,926	34,106	28,459	124%
	32,639	20,237	29,404	24,851	123%
	31,039	19,174	26,955	23,282	121%
	24,994	16,179	21,984	19,621	121%
	31,081	19,328	27,033	23,416	121%
	38,942	23,338	34,102	28,260	121%
	25,624	16,642	22,618	20,148	121%
	29,289	18,448	25,638	22,224	120%
	26,011	16,685	22,493	20,084	120%
	46,407	27,009	39,846	32,437	120%
	31,627	19,466	26,810	23,178	119%
	51,492	29,604	43,085	35,091	119%
	33,290	20,548	28,239	24,022	117%
	48,957	27,241	38,611	31,718	116%
	31,358	19,605	26,770	22,812	116%
	20,707	13,826	17,846	16,007	116%
	52,085	29,885	41,569	33,670	113%
	45,079	26,217	34,623	28,995	111%
	41,135	24,409	31,958	26,733	110%
	53,966	30,886	40,459	32,868	106%
	34,162	20,983	25,101	21,777	104%
Average	**$35,706**	**$21,496**	**$31,109**	**$26,194**	**122%**

Table 9 (continued)

	PRE-RETIREMENT Gross*	PRE-RETIREMENT Disposable	POST-RETIREMENT Gross	POST-RETIREMENT Disposable	Adequacy Ratio
Fire	$51,383	$29,547	$44,329	$35,984	122%
	37,849	22,791	33,095	27,534	121%
	49,570	27,538	40,618	33,164	120%
	47,456	26,490	38,466	31,615	119%
	38,951	23,206	32,677	27,581	119%
	64,055	34,666	51,652	41,105	119%
	42,767	25,084	35,632	29,724	118%
	50,913	29,303	42,243	34,487	118%
	42,068	24,096	33,909	28,331	118%
	55,740	30,608	44,468	35,937	117%
	62,799	34,081	50,058	39,958	117%
	53,801	29,636	42,796	34,726	117%
	57,106	32,505	46,775	37,420	115%
	57,637	31,547	44,648	36,061	114%
	56,042	31,957	45,477	36,486	114%
	70,761	37,783	54,032	42,972	114%
	49,919	28,741	39,614	32,260	112%
	54,695	31,258	42,840	34,902	112%
	52,332	28,911	39,235	32,160	111%
	41,075	23,653	31,002	26,237	111%
	46,882	27,242	36,687	30,160	111%
	49,726	28,638	38,783	31,668	111%
	57,493	32,708	44,992	36,140	110%
	51,365	29,532	39,463	32,491	110%
	64,306	34,778	46,411	37,493	108%
	55,041	30,258	39,702	32,501	107%
	55,639	31,756	41,764	33,808	106%
	52,127	29,930	37,460	31,048	104%
Average	**$52,482**	**$29,580**	**$41,387**	**$33,713**	**114%**
OVERALL AVERAGE	**$42,933**	**$24,978**	**$35,536**	**$29,433**	**119%**

* Pre-retirement gross includes vacation lump sum payments made at retirement.

SOURCE: Audit Services Division analysis based on records from City of Portland and PERS.

Appendix 3 Effect of Salary Supplements on Benefit Levels

PERS considers all wages paid to an employe in calculating benefits, regardless of whether the pay was a straight hourly wage, premium pay, overtime, or vacation lump sum payment when the employe retires. In addition, the City of Portland participates in the PERS sick leave conversion option, which allows employes to use 50 percent of their accrued sick leave to enhance their monthly retirement benefits. Table 10 shows the relative effects of vacation, sick leave, and overtime on employe retirement benefits. The example is a general service employee who is 58 years of age, has 30 years of service, and makes $10.00/hour.

Table 10 Effects of Salary Supplements to PERS Benefits

	Base Pay	Add 100 Overtime Hours	Add 100 Vacation Hours	Add 100 Sick Leave Hours *
Final Average Salary (FAS)	$1,837	$1,882	$1,867	$1,852
Monthly Benefit (.0167 x FAS x 30 years)	$920	$943	$935	$928
Percent increase in benefit		2.4%	1.6%	0.8%

* 50% (50 hours) of sick leave is used

SOURCE: Audit Services Division Analysis.

Appendix 4 Benefit Provisions of Other State PERS Compared to Oregon

Table 11 describes the pension benefit formulas for Oregon and 16 other public employe retirement systems. All the formulas multiply three factors to determine the pension payment: a constant number, the final average salary, and the years of service.

The first column of the Table 11 shows the formula multiplier used by the different systems. The higher the multiplier, the greater the benefits. Columns 2, 3, and 4 show the variations in determining the final average salary. The systems may use an employe's last three, four, or five years of earnings. Generally, the shorter the time period, the greater the benefits. Some systems allow the value of accrued sick and vacation time to be considered as part of the employe's earnings, usually with some limitations. Overtime earnings may also be included in the calculation of the employe's final average salary. These additions to employe earnings increase the level of benefits, especially when the period of earnings is only three years.

Column 5 indicates whether the retirement systems allow the employe's years of service to be extended with accrued vacation or sick leave. Additions to the years of service will increase the level of retirement benefits.

Federal law generally limits pension benefit levels to no more than 100 percent of pre-retirement earnings, but Column 6 indicates those systems which place even lower limits on allowable benefits.

Column 7 shows that some of the systems we surveyed had an income tax which applied to the benefits of public employe retirement systems. If pension payments are exempt from state income tax, the retiree's net benefits could be higher.

The table also includes the member contribution rates of the surveyed retirement systems in Column 8. A more generous benefit formula could be related to a higher level of member contributions.

Column 9 shows the number of years a public employe must work before becoming vested in the retirement system. Generally, a shorter vesting period offers more employes the opportunity to receive retirement benefits.

Table 11 Other State PERS Compared to Oregon

	1	2	3		4	5		6	7	8	9
STATE	Formula multiplier	Yrs. for salary average	Allow salary supplement:?		Include over-time?	Allow service extension?		Benefit limit *	Exempt from State tax?	Member contrib. rate	Years to vest
			Vac.	Sick		Vac.	Sick				
Arizona	2%	3	N	Y	Y	N	N		N	5.53%	5
Illinois	1-1.5%	4	N	Y	Y	N	Y	75%	Y	4.5%	8
Indiana	1.1%	5	Y	Y	Y	N	N		N	3%	10
Iowa	1.67%	5	N	N	Y	N	N	60%	N	3.7%	4
Kansas	1.25-1.5%	4	Y	Y	Y	N	N		Y	4%	10
Kentucky	1.91-2%	5	N	N	Y	N	Y		Y	4.25 or 5%	5
Maryland	.8-1.5%	3	N	N	N	Y	Y		N	0%	5
Minn.	1-1.5%	5	N	N	Y	N	N		N	4%	5
Miss.	1.75-2%	4	Y	N	N	Y	Y		N	6%	4
N. J.	1.67%	3	N	N	N	N	N		N	5-8.75%	10
Oregon	1.67%	3	Y	Y	Y	N	N		Y	6%	5
S. C.	1.82%	3	Y	N	Y	N	N		N	5.7%	5
Tenn.	1.5-1.75%	5	N	N	Y	Y	Y	75%	Y**	0 or 5%	10
Utah	2%	3	N	N	Y	N	N		N	6%	4
Virginia	1.65%	3	N	N	N	N	N	62.5%	N	5%	5
Wash.	2%	5	N	N	Y	N	N		Y**	4.9%	5
Wis.	1.6%	3	N	N	Y	Y	N	65%	N	6%	0

* As a percent of final salary

** No State income tax

SOURCE: Audit Services Division phone survey, and National Conference of State Legislatures

Responses to the Audit

CITY OF
PORTLAND, OREGON
OFFICE OF FINANCE AND ADMINISTRATION

J. E. Bud Clark, Mayor
Stephen C. Bauer, Director
1120 S.W. Fifth, Room 1250
Portland, Oregon 97204
(503) 796-5288
FAX (503) 796-3388

November 6, 1990

Ms. Barbara Clark
City Auditor

Dear Barbara:

Thank you for the opportunity to review this significant audit of the Public Employees Retirement System. The results of your audit should provide important information to both the PERS Board and the Legislature as they review current benefits and proposals for expanded benefits in the future. As your audit shows, both the Board and the legislature need to resist expanding benefits in the future.

I am asking the Personnel Bureau to compare the City's current practices regarding sick leave and vacation accruals with other major Oregon public employers to see if revisions are in order. If so, we shall recommend appropriate revisions to the City Council.

Thanks again for the opportunity to review this audit.

Sincerely,

Stephen C Bauer

Stephen C. Bauer
Director

cc: Mayor Clark
Melinda Petersen, Director, Bureau of Personnel

Bureau of Administrative Services
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CITY OF
PORTLAND, OREGON
INTERGOVERNMENTAL AFFAIRS

Marge Kafoury
Director
1220 S.W. 5th
Room 400
Portland, Oregon 97204
(503) 248-4130

November 2, 1990

The Honorable Barbara Clark
City of Portland
City Hall, Room 202
Portland, OR 97204

Dear Auditor Clark:

The Office of Intergovernmental Affairs has reviewed Audit Report #149, The City of Portland's Participation in PERS: A Review of Costs and Benefits.

The report's recommendation that this office should continue to place high priority on reviewing any legislation that affects PERS costs, shall be submitted to the City Council as part of IGA's proposed legislative agenda for 1991. The report contains information that may be useful to interested lawmakers when considering the adequacy of public employee benefits.

Sincerely,

Marge Kafoury

Marge Kafoury, Director
Intergovernmental Affairs

MK/lk

STATE OF OREGON
1859
NEIL GOLDSCHMIDT
GOVERNOR

Oregon Public Employes Retirement System
HEADQUARTERS: 200 SW MARKET STREET, SUITE 700, PORTLAND
MAILING ADDRESS: PO BOX 73, PORTLAND, OR 97207-0073 PHONE (503) 229-5824

In Response,
Refer to Acct.#

October 25, 1990

MEMORANDUM

TO: Barbara Clark, City Auditor

FROM: Sheryl Wilson, Director Sheryl Wilson

SUBJECT: City of Portland Report on Participation in PERS

Thank you for inviting me to comment on your report. I am pleased that the City has taken an interest in the benefits and costs of the Public Employes Retirement System. Your work will contribute to a clearer understanding of what part PERS plays in your benefits structure.

The PERS Board will read your report with interest. The Board is especially interested in how rates affect its member employers. To that end the Board has endeavored to keep rates as steady as possible, to aid employers in correctly anticipating budget needs.

One action that has helped stabilize rates for local governments was taken in 1988. At that time the Board revised rates based on an actuarial valuation of the System. Rates for most local government employers went down. For those employers whose rates were projected to increase, the increases were phased in over a two-year period. In another move to stabilize rates for local governments, the Board voted in October of this year to eliminate rate changes planned for 1991 and keep rates steady at least through July of 1992.

I appreciate the time your staff members spent with me reviewing the report as well as their openness to my comments.

Q. Aren't generous retirement benefits needed to make up for low wages in the public sector?

A. According to the independent Portland Area Compensation Survey, public union members' wages are at or above the top of the range for the private sector. Nonretirement benefits such as health care are also higher for public employees.

Q. What about retirees who do not qualify for full PERS benefits?

A. Their income tends to be lower, because other employers typically offer less generous benefits. Audit staff were unable to locate any plan outside government with a goal of continuing the employee's same standard of living. According to the Employee Retirement Research Institute, the median annual pension income of private sector retirees is $4,208.

Q. Don't most people die soon after retirement?

A. PERS statistics indicate male retirees live until age 80, and females until 85, on the average. Fire and police officers appear to live as long as other retirees. The trend is toward even longer lives.

Q. Aren't retirement benefits just a return of dollars contributed by the employee in the first place?

A. For PERS and Social Security, most employees currently contribute 7.5% of salary, and the employer contributes around 24.5%. If benefits increase in the future, or PERS investments do not perform as well as expected, the employer pays more. Typically, retirees receive many more dollars than paid in, with the government making up the difference.

Q. Could benefits be decreased later if the cost turns out to be prohibitive?

A. No. The effect of Oregon Supreme Court decisions is that benefits can be increased but not decreased.

Q. Are untaxed benefits a contractual obligation?

A. This question should be settled through the courts.

BC
FYI

OREGON AFSCME News Release

The City of Portland's recent study regarding pension benefits paid to retired city workers paints an unrealistic picture of the typical city retiree ... and was likely released with ulterior motives in mind.

Tom Gunn, Council Representative for AFSCME Local #189 and spokesman for the District Council of Trade Union (DCTU), which represents 1,700 city employees, said the city's recent study focuses only on employees who retire with 30 years or more of service who have accrued the maximum levels of sick leave, vacation and overtime.

"Most retirees don't fall into that group," said Gunn, "so from that standpoint, the study does not reflect the average city retiree.

"Beyond that, what kind of employees should a municipal jurisdiction seek?" Gunn asks. "Most employers are looking for long-term employees ... people who don't take a lot of sick time ... who show up for work and put in their hours every day -- even overtime hours if asked to. In other words, a good, conscientious employee who does his or her job."

Gunn said the understood goal of any pension plan, be it in the public or private sector, is to reward good employees with a comparable standard of living once they retire.

"The report correctly points out that there is no evidence that city employees nearing retirement change their work habits in an effort to maximize their pension benefits," said Gunn. "But if you've worked 30 years anywhere ... be it with the City of Portland, Georgia-Pacific or IBM ... and you've not missed many days, not taken a lot of vacation time and have worked a lot of overtime, you should be 'rewarded' by having a good pension. That's one of the primary goals of a pension plan -- to reward good, long-term employees upon their retirement."

Gunn noted that the study focuses on "disposal income" based on money retirees receive from both the state PERS system and Social Security.

"In both cases," said Gunn, "those are funds in which the employee has contributed, along with the city. PERS and Social Security benefits are not 'gifts' from the city."

Gunn emphasized that most city retirees don't have 30 years of service and haven't accrued the maximum levels of sick leave and vacation accrual. He said those retirees -- the majority of retirees -- face serious economic problems in retirement in the face of skyrocketing health care costs.

Moreover, Gunn questions the timing of the report's release.

"It's no secret that the city is concerned about its upcoming negotiations with the police and fire personnel," said Gunn. AFSCME and the DCTU do not represent the city's police officers or fire fighters.

"Why release this study now?" Gunn asks. "I believe the city has its eye on the binding interest arbitrations scheduled for early next year with the police and fire unions. The study gives the city a document to throw on the table and say 'Hey! We're paying enough already!'

"In other words, it's simply a negotiations ploy by the city, but it comes at a bad time, in light of the concerns over the passage of Ballot Measure 5."

Gunn added that he fully expects the City of Portland to ask the 1991 Oregon Legislature for a reduction in the employer contribution to the PERS system. He noted that City Auditor Barbara Clark's report accurately points out that it is the Legislature which makes the PERS rules and sets the limits, not the city or the unions.

"Succinctly, it was a very selective study -- put out for ulterior motives -- that paints an unrealistic picture of the City of Portland's overall retirement program," Gunn concluded.

11/14/90

Municipal retirees do well not working

☐ Portland rewards its employees with pensions that on average exceed their take-home pay

By BARNES C. ELLIS
of The Oregonian staff

City of Portland workers take home more pay in retirement than they did on the job, according to a city report to be released Wednesday.

An analysis by City Auditor Barbara Clark found that, over the past three years, career city workers enjoyed an average annual disposable retirement income of about $29,000. Before retirement they averaged $25,000.

That's effectively a $4,000 raise for retiring.

Most Portland workers are covered by two retirement programs: Social Security and the state-run Public Employes Retirement System. The goal of of the system is to provide career employees with the same standard of living in retirement that they had at the end of their careers.

But it doesn't work that way in Portland.

Benefits are based on a percentage of a worker's salary before retirement. But because the base may be adjusted to include overtime pay, half the value of all unused sick leave and lump-sum payments for unused vacation time, it can grow much bigger.

Because Portland has higher caps for accrual of sick leave and vacation time than some other cities, Portland employees often qualify for big adjustments. The study found that general-service retirees on average had 1,457 hours of unused sick leave, 478 hours of unused vacation time and 120 hours of paid overtime.

Fire employees had even bigger adjustments.

"It doesn't sound right to me," said City Commissioner Mike Lindberg, who had not yet read the report. "It doesn't sound fair. We need to review that issue of accruing all the sick leave."

The retirement system bills shared by the city and its workers have nearly doubled in the last decade, from $9 million to $17.9 million. But the city has a limited ability to control the costs. Although PERS employers can place some lim-

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Audit: Bills grow 100% in decade

■ **Continued from Page One**

its on salary supplements, the Oregon Supreme Court has held that labor contracts also constrain these actions, according to the report.

"As a result, pension benefits for current employees typically can be increased but not decreased," the report said.

Clark noted that the Legislature, which enacts most of the retirement system rules, also benefits from most of them. And she added that Measure 5, Oregon's new property tax limitation, would have no effect on the retirement benefits.

"The court system of Oregon has said that all of these retirement benefits have to be paid before we start in on dollar one of services to the public," she said. "No matter how much tax limitation there is, it will have no effect on the retirement benefits unless the laws are changed."

Auditor Clark said that Portland retirees do not appear to adjust their work habits during their final years of employment in order to increase their benefits.

However, the report of 16 other state retirement systems of similar size and operation showed that the Oregon system "provides more opportunities for generous benefits."

"Other states generally limit the addition of unused sick leave and vacation to benefit calculations," the report said.

Employee benefits are a large and growing part of the city's costs, according to the report. In fiscal year 1989-90, Portland spent more than $72.8 million for health, dental and life insurance, retirement and disability pay and other benefits for its employees.

The sum represents 31 percent of total employee compensation, up from 26 percent 10 years ago.

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SATURDAY, NOVEMBER 17, 1990

City lesson on pensions

There's no question but that public employees in Oregon have generous retirement benefits. How generous was documented by Portland City Auditor Barbara Clark in a recent report on pension benefits for recently retired career employees — those who worked more than 30 years for the city, or, in the case of firefighters, 25 years.

Clark calculated that these long-time employees were actually doing better in terms of disposable income — pension plus Social Security — than they were before they retired.

That doesn't mean that the city or the Public Employes Retirement System was paying them more than they had been earning on the job. Along with Social Security, public employees have benefited in take-home pay because Oregon hasn't taxed their pensions. Combine pension with Social Security, allow for no state taxes and lower federal ones, and the take-home pay adds up.

Also, many employees retire on lower pensions because they have fewer years on the job.

But Clark makes a point that city pensions are exceeding the goal set forth by the Public Employes Retirement System: that career employees end up with the same standard of living after retirement as they enjoyed before. That's a point the Legislature should remember when it is tempted, as it always is, to make technical adjustments fattening public employees' retirement benefits. Portland might be a bit more generous in its pension plan than other jurisdictions, but its case is illustrative of the situation around the state.

Among costly changes that could come forward in the next session is one committing public employers to maintaining health insurance for retired employees. There's just no reason to extend that kind of costly benefit to public employees when the other taxpayers paying for it don't receive it.

Other possible "technical adjustments" to watch for are such things as increasing the multiplier for calculating retirement benefits or adding to what can be used to increase the income base that goes into the calculation. Clark's audit notes that one reason Portland city pensions are relatively generous is that more overtime pay, unused sick leave and untaken vacation time are factored in.

In another fattening try, the Legislature probably also will be urged to increase benefits because the retirement fund has done very well with its investments. That's not the right step. Especially with the passage of Measure 5, the property tax limitation, any surplus should be used to make actuarially sound reductions in the pension costs to local and state government.

Without that dampener on pension costs, local governments, especially in urban areas, could be in a bad squeeze, Clark notes. Currently, local governments cannot lower pension benefits, and funding pensions has a high-priority claim on their funds, even if Measure 5 forces reductions in other spending.

Legislative restraint in increasing pension benefits would not be denying public employees their due. Clark shows that they are receiving their due, maybe more. Rather, restraint would recognize that public employees' benefits need to reflect not only the lobbying clout of those employees, but also their cost — plus fairness to those other taxpayers who are footing the bill.

11/17/90

Ex-congressmen live well on fat pensions

By JOHN FAIRHALL
The Baltimore Sun

WASHINGTON — Rep. Roy P. Dyson, D-Md., who lost his seat in Congress last week, can find solace in the lucrative congressional pension system.

Dyson, who turned 42 Thursday, is entitled to a pension of $26,355 a year at age 60, plus annual cost-of-living adjustments thereafter.

Dyson's pension is calculated on the basis of 10 years in Congress and 1½ years of service as a congressional aide in the 1970s. The longer a member serves, the more he or she stands to receive in pension benefits.

Critics of the pension system say that it is overly generous, unaffordable and becoming more of a burden on taxpayers as congressional pay rises. Since the pension is based on a lawmaker's last three years of salary, pension benefits of House members will start rising sharply after their pay goes up from $96,600 to an estimated $125,000 in 1991.

"The benefits are outrageously generous," said David Keating, executive vice president of the private, non-profit National Taxpayers Union. "After 1993, 23 congressmen could receive annual benefits in excess of the 1989 $89,500 annual salary. One hundred could receive over $50,000."

If House Minority Leader Robert H. Michel, R-Ill., had lost last week's election, for example, he would have started drawing a pension of $77,058 a year beginning in 1991, based on more than 45 years of government service.

Michel's pension would increase by $27,000, to $104,000 a year in 1993, as a result of the pay increase and an additional two years of service, according to the taxpayers organization.

Critics are concerned with the civilian and military pension system, not only the congressional system, which benefits House and Senate members. The annual cost of federal civilian and military pensions is $55 billion, up from $5.3 billion in 1970, says Hastings Keith, head of the private, non-profit National Committee on Public Employe Pension Systems.

The congressional pension system comes under the most fire because it is more generous than the regular federal-worker system, and far more generous than private-sector retirement plans, says William Pierce, a spokesman for the taxpayers union.

The median annual income of private-pension retirees is $4,208 annually, reports the Employee Retirement Research Institute. That is less than 20 percent of the pension Dyson will get for 11½ years of service.

Most private pension systems do not have cost-of-living increases nor do most follow the formula used by Congress.

A lawmaker's pension is calculated by multiplying the average annual salary in the last three years by 2.5 percent, then multiplying that result by the number of years of service. By contrast, most private pension systems use a multiplication factor of 1.5 to 1.74 percent, institute officials say.

Members of Congress say in their defense that they pay 8 percent of their salaries into their retirement system. But the taxpayers union says that covers only a fraction of their benefits, leaving taxpayers to foot most of the bill.

Over a lifetime, a retired lawmaker could receive a few million dollars, Keating says.

Keith of the public pensions committee uses himself as a prime example of the need to reform the pension system, especially the cost of living allowances. A former member of Congress from Massachusetts who served from 1958 to 1972, he says he receives $90,408 a year in ever-increasing federal pensions based on four sources: congressional and federal agency service, military duty, Social Security and an annuity from the federal pension received by his late wife.

His pension payments originally totaled $18,720 a year, he says.

12% in U.S. get 60% of social spending

By RICHARD D. LAMM

Progressivity in taxation — the idea that those who earn more should pay more of the costs of government — is an old idea that has found new vigor.

Congress, insistent on taxing the rich, has just passed a budget that gives approximately 60 percent of our federal social spending to just 12 percent of our citizens: Americans over 65. Yet, the elderly have the highest disposable income and the lowest rates of poverty of any group in America. They own one-third of all household assets and 40 percent of all financial assets.

Poverty in America is more likely to wear diapers than a hearing aid. Nevertheless, Congress in 1987 spent $10,010 per capita on the elderly and only $854 per child. We may want to tax the rich, but we also distribute our federal largess not on the basis of who needs it but on who has the political power.

There's little question that the elderly are the most politically powerful group in America. It's highly questionable whether they are the most deserving.

To be sure, there are many poor Americans over 65, and I'm very proud that my Democratic Party pioneered Social Security and Medicare, which were invaluable in lifting many of the elderly out of poverty. But today there are many retirees receiving overgenerous federal transfer payments who just don't need them.

For example, through Medicare we are paying the health costs of hundreds of thousands of elderly millionaires, while 20 percent of America's kids don't have all their vaccinations and 600,000 American women give birth every year without adequate or any prenatal care. We have recently amended Medicare to pay for heart transplants, yet 31 million Americans go without health insurance. We have a life expectancy rate of 80 years, the highest in the world, yet we rank 18th in infant mortality.

Even programs designed specifically for the poor are being slanted toward the elderly. Medicaid, a program aimed originally at poor women and children, today devotes 27.6 percent of its funds to long-term care for the elderly. While this money does go toward the poor elderly, it is nevertheless symbolic of how our limited resources are being taken away from the majority of the population.

Public policy should transfer money from the rich to the poor, not from the young to the old.

We have created an excessive sense of entitlement in the elderly, and they are vociferous in defending and enlarging their benefits. Our political establishment, supposedly trained to meet new needs with new spending, finds it impossible to reallocate existing spending. But there is not enough new wealth being created to solve all our new challenges: New needs, to some degree, will have to come from reallocated resources.

In short, we cannot make fiscal sense of our future without eventually taking on entitlements for the elderly. Moreover, if we are to leave a sustainable nation for our children, we have to spend more money on the next generation and less money on the last one.

It is not good public policy to transfer federal monies to the millionaire elderly while less than 30 percent of our children in need have access to Head Start programs.

If we are going to initiate a luxury tax, why don't we tax further Social Security and Medicare for those seniors who are in the high-income brackets? If we are going to tax the rich, at least we should have the backbone to look at "progressivity" on the spending side of government.

Richard D. Lamm, former governor of Colorado, is professor of public policy at the University of Denver. He wrote this article for The New York Times.