

IN THE SUPREME COURT OF THE STATE OF OREGON

EVERICE MORO; TERRI DOMENIGONI; CHARLES CUSTER; JOHN HAWKINS; MICHAEL ARKEN; EUGENE DITTER; JOHN O'KIEF; MICHAEL SMITH; LANE JOHNSON; GREG CLOUSER; BRANDON SILENCE; ALISON VICKERY; and JIN VOEKS,

Petitioners,

v.

STATE OF OREGON; STATE OF OREGON, by and through the Department of Corrections; LINN COUNTY; CITY OF PORTLAND; CITY OF SALEM; TUALATIN VALLEY FIRE & RESCUE; ESTACADA SCHOOL DISTRICT; OREGON CITY SCHOOL DISTRICT; ONTARIO SCHOOL DISTRICT; BEAVERTON SCHOOL DISTRICT; WEST LINN SCHOOL DISTRICT; BEND SCHOOL DISTRICT; and PUBLIC EMPLOYEES RETIREMENT BOARD,

Respondents,

and

LEAGUE OF OREGON CITIES; and OREGON SCHOOL BOARDS ASSOCIATION,

Intervenors.

S061452 (Control)

WAYNE STANLEY JONES,

Petitioner,

v.

PUBLIC EMPLOYEES RETIREMENT BOARD; ELLEN ROSENBLUM, Attorney General; and JOHN A. KITZHABER, Governor,

Respondents.

S061431

MICHAEL D. REYNOLDS,

Petitioner,

v.

**PUBLIC EMPLOYEES RETIREMENT BOARD, State of Oregon; and JOHN A.
KITZHABER, Governor, State of Oregon,**

Respondents.

S061454

GEORGE A. RIEMER,

Petitioner,

v.

**STATE OF OREGON; OREGON GOVERNOR JOHN KITZHABER; OREGON
ATTORNEY GENERAL ELLEN ROSENBLUM; OREGON PUBLIC
EMPLOYEES RETIREMENT BOARD; and OREGON PUBLIC EMPLOYEES
RETIREMENT SYSTEM,**

Respondents.

S061475 & S061860

**SPECIAL MASTER'S PRELIMINARY REPORT AND RECOMMENDED
FINDINGS OF FACT**

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I. Introduction

Petitioners in these consolidated cases have filed petitions and amended petitions for review in the Oregon Supreme Court challenging the validity of certain parts of Oregon Laws 2013, chapter 53 (SB 822) and Oregon Laws 2013 Special Session, chapter 2 (SB 861). The petitions were all filed directly in the Oregon Supreme Court pursuant to section 19 of SB 822 and section 11 of SB 861. The court consolidated the cases for purposes of judicial review, and appointed the undersigned as Special Master to compile a record, hold an evidentiary hearing, and make recommended findings of fact for the consolidated cases.

The Public Employees Retirement System (PERS) is complex. It was described in detail in *Strunk v. PERB*, 338 Or 145 (2005), and in the Special Master's Written Report and Recommended Findings of Fact dated April 8, 2004 ("the 2004 Special Master's Report").¹ The Supreme Court relied on and largely adopted the 2004 Special Master's Report in *Strunk*. This report does not attempt to duplicate the work done in the *Strunk* litigation. Instead, this report adopts the 2004 Special Master's Report and supplements it with additional findings that may be pertinent to the claims and defenses presented in this litigation.²

¹ The 2004 Special Master's Report is included in the record as Ex. 15.

² The parties do not agree that the factual findings in this report are relevant or even necessary to assist the Supreme Court in resolving the claims and defenses presented in these consolidated cases.

II. Summary of Claims and Defenses

A. Petitioners' Claims

Petitioners are all current or retired public employees and PERS members. Some petitioners are also members of the Oregon Public Service Retirement Plan (OPSRP). Petitioners Everice Moro, Terri Domenigoni, Charles Custer, John Hawkins, Michael Arken, Eugene Ditter, John O’Kief, Michael Smith, Lane Johnson, Greg Clouser, Brandon Silence, Alison Vickery, and Jin Voeks (“the Moro petitioners”) are represented by counsel. Petitioners Wayne Stanley Jones, Michael D. Reynolds, and George A. Riemer are self-represented litigants.

Eleven of the Moro petitioners—all except petitioners Silence and Voeks—allege that the changes to the annual Cost of Living Adjustment (COLA) to PERS benefits made by sections 1 and 3 of SB 822, and Sections 1 and 8 of SB 861, unconstitutionally impair their employment contracts in violation of Article I, section 21 of the Oregon Constitution (First Claim) and Article I, section 10, clause 1 of the United States Constitution (Second Claim). The same petitioners further allege that those COLA changes amount to an unconstitutional taking of their property without just compensation in violation of Article I, section 18 of the Oregon Constitution (Third Claim), and breach their PERS contracts if not unconstitutional (Fourth Claim).

Petitioners Silence and Voeks allege that the COLA changes to OPSRP provided by sections 5 and 7 of SB 822, and sections 3 and 8 of SB 861, unconstitutionally impair their employment contracts in violation of Article I, section 21 of the Oregon Constitution (Fifth Claim), and Article I, section 10, clause 1 of the United States

Constitution (Sixth Claim). Petitioners Silence and Voeks further allege that those COLA changes amount to an unconstitutional taking of their property without just compensation in violation of Article I, section 18 of the Oregon Constitution (Seventh Claim), and breach their OPSRP contracts if not unconstitutional (Eighth Claim).

Petitioners O’Kief and Smith allege that sections 11-17 of SB 822 change their additional benefits granted pursuant to 1991 Oregon Laws chapter 796 (SB 656)³ in ways that unconstitutionally impair their contracts with their public employers in violation of Article I, section 21 of the Oregon Constitution (Ninth Claim), and Article I, section 10, clause 1 of the United States Constitution (Tenth Claim). Petitioners O’Kief and Smith further allege that the changes to those benefits amount to an unconstitutional taking of their property without just compensation in violation of Article I, section 18 of the

³ The parties do not agree on the characterization of those benefits. Petitioners call the benefits under SB 656 and 1995 Or Laws, ch. 569 (HB 3349) as “SB 656/HB 3349 benefits.” The State Respondents call them a “tax remedy.” In *Stovall v. State of Oregon*, 324 Or 92 (1996), the Supreme Court explained that PERS benefits were exempt from state income taxes from 1945 until 1991. In 1991, after the United States Supreme Court decided *Davis v. Michigan Dept. of Treasury*, 489 US 803 (1989), the legislature passed Oregon Laws 1991, chapter 823, which eliminated the state tax exemption. *Stovall*, 324 Or at 98-99 (describing history). In *Hughes v. State of Oregon*, 314 Or 1 (1992), the Oregon Supreme Court held that Oregon Laws 1991, chapter 1, violated Article I, section 21, of the Oregon Constitution, and that section 3 of that law “breached petitioners’ PERS contract insofar as it subjects to state taxation PERS retirement benefits accrued or accruing for work performed before the effective date of that 1991 legislation.” *Stovall*, 324 Or at 99 (quoting *Hughes*, 314 Or at 36). The *Stovall* court stated that SB 656 “provided for increased PERS benefits in lieu of the tax exemption” (324 Or at 102), and that HB 3349 “provided for increased compensation to PERS members as to whom the state had breached its contract to provide tax-free pension benefits.” *Id.* at 104. This report uses the term “SB 656/HB 3349 benefits” to describe the benefits at issue without deciding which party’s characterization of those benefits is more accurate.

Oregon Constitution (Eleventh Claim), and breach their PERS contracts if not unconstitutional (Twelfth Claim).

Petitioners Jones, Reynolds, and Riemer (“the self-represented petitioners”) join in the Moro petitioners’ claims, and they filed separate petitions alleging that SB 822 and SB 861 change their COLA and SB 656/HB 3349 benefits in ways that impair their contracts with their public employers in violation of Article I, section 21 of the Oregon Constitution, and Article I, section 10, clause 1 of the United States Constitution. The self-represented petitioners also allege that SB 822 and SB 861 amount to an unconstitutional taking of their employment contracts with their public employers, and breach their employment contracts if not unconstitutional. Petitioner Reynolds also alleges that the reduction of benefits provided by sections 11-16 of SB 822 violates 4 USC § 114(a), making those sections invalid under the Supremacy Clause, Article VI, clause 2 of the United States Constitution.

B. Respondents’/Intervenors’ Defenses

Respondents and Intervenors deny that SB 822 and SB 861 unconstitutionally impair or breach petitioners’ contracts, or that they amount to an unconstitutional taking of petitioners’ property. Respondents State of Oregon; Public Employees Retirement Board; Governor John A. Kitzhaber; Attorney General Ellen Rosenblum; and the Oregon Public Employees Retirement System (“State Respondents”) do not assert any affirmative defenses. The City of Portland; the City of Salem; the Beaverton School District; and Intervenor League of Oregon Cities do not assert any affirmative defenses, either.

Respondent Tualatin Valley Fire & Rescue (“TVF&R”) assert the following affirmative defenses: (1) the court lacks subject matter jurisdiction to address claims against TVF&R (First Defense); (2) the petitioners who worked for TVF&R—petitioners Custer and Ditter—have failed to state a claim for relief against TVF&R (Second Defense); (3) the claims are barred by the applicable statute of limitations for actions on breach of contract (Third Defense); and (4) the claims are barred by the applicable statute of ultimate repose (Fourth Defense).

Respondents Estacada School District, Oregon City School District, Ontario School District, West Linn School District, and Bend-LaPine School District (“the School District Respondents”), joined by respondent Linn County and intervenors Oregon School Board Association and Association of Oregon Counties, assert an “economic hardship” defense to the Moro petitioners’ claims.⁴ Specifically, they allege that, if the Oregon Supreme Court finds that SB 822 or SB 861 substantially impairs contractual rights in violation of the Oregon or United States Constitution, then the change to contractual rights caused by SB 822 or SB 861 is constitutional because it is justified by the important, significant and legitimate public purpose of remedying a broad and general economic problem, and the bills were reasonable and necessary to advance that public interest.⁵

⁴ The 2004 Special Master’s Report referred to a similar defense as an “economic hardship” defense. This report uses the same terminology without expressing any opinion as to the nature and characterization of that defense.

⁵ Intervenors Oregon School Board Association and Association of Oregon Cities assert the same defense in answers to the claims asserted by the self-represented petitioners.

III. Summary of Fact Finding Procedures

To streamline the fact-finding process, the Special Master received affidavits and declarations from various witnesses in lieu of direct examination, and required that the declarants be made available for cross-examination upon request. The Special Master took additional testimony at an evidentiary hearing held on April 2nd and 3rd, 2014, and received the following into evidence: Exhibits 1-80 from the petitioners; Exhibits S1-S27 from the State Respondents; Exhibits SDLC 101- SDLC109 from the School District respondents, Linn County, and intervenors Association of Oregon Counties and Oregon School Board Association; Exhibit P1 from the City of Portland; and Exhibit TVFR 1 from TVF&R.⁶ Before the evidentiary hearing, all parties were encouraged to stipulate to facts that were not in dispute. The parties each submitted proposed stipulated facts and responses to proposed stipulated facts.

After the evidentiary hearing, the parties submitted supplemental proposed findings of fact and a set of Joint Stipulated Facts. The Special Master heard additional argument on April 18, 2014. The Special Master circulated a preliminary report to the parties, considered any objections to the preliminary report, and then finalized the report and submitted it to the Supreme Court.

The “Explanatory Observations” at pages 1-4 of the 2004 Special Master’s Report apply equally here and are adopted and incorporated herein. In addition, I have received

⁶ After the evidentiary hearing, the Moro petitioners moved to supplement the record to add Exhibit 81, the April 2014 issue of the PERS newsletter, “PERSPECTIVES.” The Moro petitioners withdrew that request at the April 18 hearing.

evidence into the record despite relevance objections by one or more of the parties, on the theory that the Supreme Court will decide which evidence, if any, is relevant to its review. Intervenor League of Oregon Cities asked me to make only one factual finding: that fact-finding was not necessary to resolve the petitions before the Supreme Court. I decline to make that finding, leaving it to the Supreme Court to decide whether fact-finding was necessary.

This report does not attempt to summarize all the materials included in the legislative history for SB 822 and SB 861, nor does it include statements in the legislative history for prior legislation affecting PERS.⁷

IV. PERS OVERVIEW

The general operation of the PERS system is described at pages 8-22 of the 2004 Special Master's Report. This report supplements that description with the additional facts set forth in this section.

The ultimate cost of PERS or any other pension plan is generally governed by the following equation: $\text{Benefits} = \text{Contributions} + \text{Actual Investment Earnings}$. For PERS, the Oregon Legislature sets benefits, the PERS Board sets contributions, and Actual Investment Earnings are investment returns on PERS assets, driven by asset allocation as determined by the Oregon Investment Council. The PERS Board has consistently elected

⁷ Legislative history materials for various PERS legislation enacted from 1971-2013 are included in the record as Exs. 50 through 60.

to follow a prudent path that attempts to balance at-times competing objectives of contribution rate stability, restoring system funded status, and intergenerational equity.⁸

The PERS Fund may have an unfunded actuarial liability (UAL) at any given time. The UAL is the amount by which the actuarial accrued liability of the fund exceeds the actuarial value of the fund's assets. The PERS Board can address the UAL by affecting the amount of contributions through employer rates. Employer rates are expressed as a percentage of salary paid to PERS-covered employees. The PERS Board can control the timing of contributions, not the ultimate total of necessary contributions. Employer rates are set by the PERS Board in consultation with the actuary to eliminate the UAL over a certain amortization period (for the valuation pertinent to this litigation, 20 years).⁹

One component of the "Benefits = Contributions + Actual Investment Earnings" formula that can be changed to reduce the UAL is the cost of benefits to be paid. To have an appreciable effect on employer rates, benefit changes need to reduce the system's accrued liability on an order of billions of dollars.¹⁰

As of December 31, 2011, 68% of the system's accrued liability was owed to members who were no longer actively employed: 60% was owed to retired members, and 8% to inactive members. Because a combined 68% of the system's accrued liability

⁸ Joint Stipulated Facts, p. 4, ¶¶ 1, 2.

⁹ Joint Stipulated Facts, p. 5, ¶ 5.

¹⁰ Joint Stipulated Facts, p. 8, ¶ 18.

was attributable to members no longer employed, any “cost-containment” measure designed to address the system’s UAL that did not include these members would leave out a large segment of the members whose benefits were driving system costs. For example, proposals that only reduced benefits to be paid to active members in future years would place the entire burden of the cost reductions on members representing 32% of the accrued liability. Similarly, proposals to create another benefit tier for new employees would not affect the existing UAL, because UAL measures accrued benefits as of the valuation date. If the legislature denied all retirement benefits to new public employees, that would have no effect on the existing UAL.¹¹

The PERS Board sets employer contribution rates biennially. Rates are based on actuarial valuations conducted with measurement dates in odd-numbered years. The rates are actuarially calculated, using a variety of assumptions and methods. These assumptions include long-term investment return assumptions and life expectancy for retirees. The methods and assumptions used by the actuary are reviewed by the PERS Board biennially.¹²

The PERS actuary calculates individual employer contribution rates for each of the hundreds of participating PERS employers. Periodic actuarial analysis presented to the Board includes average rates on a system-wide basis.¹³ Throughout these findings of

¹¹ Joint Stipulated Facts, p. 9, ¶ 19.

¹² Joint Stipulated Facts, p. 5, ¶ 6.

¹³ Joint Stipulated Facts, p. 20, ¶ 12.

fact, references to employer rates are to those system-wide employer rates unless otherwise indicated.

V. PERS STATUS BEFORE THE 2013 LEGISLATION

A. Status at the Time of the *Strunk* Litigation

The status of the system before the enactment of the 2003 legislation and the changes to the system following the 2003 PERS legislation that were at issue in *Strunk* are described in detail in the Supreme Court’s opinion in *Strunk* and the 2004 Special Master’s Report.¹⁴

B. System Changes After *Strunk*

1. Oregon Public Service Retirement Plan (OPSRP)

OPSRP, described in ORS chapter 238A, is the retirement plan for all eligible public employees hired after August 28, 2003. Although OPSRP was created as part of the 2003 PERS legislation, it was not challenged in *Strunk*. In general, a public employee who retires under OPSRP will receive a pension benefit under the Pension Program described in ORS 238A.100 through 238A.250. This pension benefit is a “defined benefit” plan. The retiree would also receive a “defined contribution benefit” under the Individual Account Program described in ORS 238A.300 through 238A.415. Since its creation in 2003, the number of OPSRP participants has steadily increased. By

¹⁴ See 2004 Special Master’s Report (Ex. 15), pp. 8-22 (describing general operation of the PERS system); pp. 22-59 (describing status of the PERS fund and events affecting the system before the 2003 legislation); pp. 59-73 (describing the 2003 PERS legislation and the challenges asserted in *Strunk*).

December 31, 2012, of the 167,103 active participants in the system, 77,666 (46.47%) participated in OPSRP.¹⁵

2. Impact of the Individual Account Program (IAP)

Beginning January 1, 2004 employee contributions were deposited to their accounts in the IAP rather than to Tier I and Tier II employee accounts. Contributions to an employee's IAP account after January 1, 2004 are not available to fund Tier I and Tier II retirement allowances. Tier I and Tier II participants receive a new benefit – the balance of the IAP account upon retirement. By 2012, the average balance of those accounts had grown to \$20,432.¹⁶

The 2004 Special Master's Report noted that the "diversion of member contributions to the IAP will reduce members' future account balances for purposes of employer matching under the Money Match formula."¹⁷ The report predicted that, "[o]n a system-wide basis, the elimination of employee contributions from the Money Match calculation probably will cause the Full Formula option to overtake the Money Match as the most common retirement formula."¹⁸

That prediction proved to be accurate. Since 2003, the percentage of retirements under the Money Match formula has diminished so that by 2012 it was no longer the retirement formula for the majority of new retirements. As of January 1, 2013, 50

¹⁵ Joint Stipulated Facts, p. 19, ¶ 5.

¹⁶ Joint Stipulated Facts, pp. 18-19, ¶ 4.

¹⁷ 2004 Special Master's Report, p. 62.

¹⁸ *Id.*

percent of new retirements were under the Full Formula method, and 45 percent were under the Money Match method. The remaining 5 percent retired under the Formula-Plus-Annuity method.¹⁹

The ratio of a retiree's initial retirement benefit to his or her last salary before retirement is known as the "replacement ratio." The average replacement ratio was at its highest for retirees under the Money Match formula in 2000. The average replacement ratio for Money Match retirees has decreased since 2000. System-wide, the average replacement ratio for all retirees was at its highest, 68%, in 2002. By 2012, the average replacement ratio for all retirees had decreased to 46%. For retirees with 30 years of service or more, the average replacement ratio was 100% in 2000; by 2012, that figure had declined to 70%.²⁰

3. *Side Accounts*

In 2001, the legislature authorized PERS participating employers to issue revenue bonds and deposit the proceeds into PERS into what have become known as "side accounts."²¹ Many employers have elected to create side accounts. By December 31, 2012, the total amount in side accounts had reached approximately \$5.5 billion.²²

Side Accounts are an outcome of individual financing decisions by public employers to deposit lump sums into the PERS trust. The lump sum proceeds are often

¹⁹ Joint Stipulated Facts, p. 18, ¶ 4; Ex. 34, p. 7.

²⁰ The replacement ratio data is found in Ex. 49, p. 5.

²¹ The statutory authority for side accounts is ORS 238.692 through 238.694.

²² Joint Stipulated Facts, p. 19, ¶ 6.

generated from the issuance of a pension obligation bond. The proceeds from the sale are deposited with PERS in the employer's Side Account. The Side Account is debited over time to pay a portion (or, at least theoretically in the case of a very large side account or a very small employer rate, all) of the employer's "base" contribution rate. The Side Account debits are typically calculated to provide a steady level of contribution as a percent of payroll from the time the Side Account is established until December 2027 if future experience follows assumptions. The amount of the employer's base contribution rate that is not covered by the side account debit is referred to as the employer's "net" rate.²³

The establishment of Side Accounts is typically associated with the issuance of a pension obligation bond. The liability and debt repayment schedule associated with those bonds are not included in PERS system liabilities. Including Side Account assets as part of the funded status of the system without including the employer liabilities associated with the Side Accounts does not fully describe the overall funded status of the system with respect to public employers.²⁴

4. Rate Collaring

In 2005, the PERS Board adopted a "rate collaring" approach to be used in setting employer contribution rates which limits the volatility of those rates. In general, under this approach, an employer's contribution rate can change from its existing rate by no

²³ Joint Stipulated Facts, pp. 14-15, ¶ 56.

²⁴ Joint Stipulated Facts, p. 15, ¶ 57.

more than 20% in a single biennium, with the excess deferred until later biennia. The employer's rate adjustment is "collared" at 20% of the existing rate (minimum of 3%) in a single biennium, though the collar expands if the employer's funded status drops below 80%. If the system experiences extraordinarily good or bad investment returns, collaring spreads the increase or decrease in employer rates over more than one biennium.²⁵

A "Rate Collar" is an actuarial methodology whereby large changes to employer contribution rates determined by the PERS actuary are spread across several biennia. There are several steps to the Rate Collar methodology. The actuary calculates an "uncollared" rate that reflects all other assumptions and methods—including UAL amortization periods—as adopted by the PERS Board. The uncollared rate is the "pure" actuarial rate, in the sense that it is the rate that would be adopted regardless of whether it is consistent with the PERS Board's principle to strive for stable and consistent employer rates.²⁶

The uncollared rate is then compared to the rate currently in effect. If the difference is large, the actual change in the rate is limited to the width of the Rate Collar. This "collared" rate is the one adopted by the PERS Board and charged to employers for the biennium. The difference between the collared and uncollared rate is "collared off"

²⁵ Rate collaring is described in Ex. 32, pp. 11-14.

²⁶ Joint Stipulated Facts, p. 14, ¶ 55.

as a deferred rate change that will occur in a subsequent biennium if future experience follows assumptions.²⁷

For example, the PERS actuary stated in a November 22, 2013 presentation to the PERS Board that average, system-wide “uncollared” employer contribution rates for the 2013-15 biennium would be 20.82%. Because the average increases were more than 20% from the rates charged during the 2011-13 biennium (average employer contribution rates, system-wide, were 16.3% in 2011-13), the increases were subject to “collar adjustments” that averaged 2.17% system-wide. Thus, the system-wide “collared” base rate for the 2013-15 biennium would be 18.65%. The collar adjustments averaging 2.17% system-wide are deferred and taken into account in setting rates in future biennia.²⁸

5. Earnings, Funding, and Employer Contribution Rates

The history of the PERS fund earnings, the system funding levels, and system-wide average employer contribution rates are detailed in a report titled “PERS: By The Numbers” dated February 2014. As shown in that report, the regular account earnings from 2003 through 2012 were as follows: 23.79% in 2003; 13.80% in 2004; 13.04% in 2005; 15.57% in 2006; 10.22% in 2007; -27.18% in 2008; 19.12% in 2009; 12.44% in 2010; 2.21% in 2011; 14.29% in 2012; and 15.59% in 2013.²⁹

²⁷ *Id.*

²⁸ The figures in this example are taken from Ex. 41, pp. 8-9 (slides 7 and 8), using numbers from the December 31, 2012 advisory actuarial valuation.

²⁹ Ex. 49, p. 16.

As of December 31, 2012, the PERS Fund was estimated to be 87% funded (including side accounts) and 78 % funded excluding side accounts. The unfunded actuarial liability (UAL) for the system was estimated to be \$8.5 billion as of December 31, 2012 (including side accounts), and \$14 billion excluding side accounts.³⁰ As of December 31, 2013, the PERS Fund was estimated to be 96% funded (including side accounts) and 87% funded excluding side accounts. The UAL for the system was estimated to be \$2.2 billion as of December 31, 2013 (including side accounts), and \$8.1 billion excluding side accounts.³¹

Employer contribution rates for participating employers are determined by the PERS Board for a two-year period based on actuarial valuations occurring every two years.³² System-wide average employer contribution base rates (which do not include reductions due to employer side accounts) from 2003 through 2012, shown as a percent of payroll, were as follows: 10.6% in 2003-05; 14.5% in 2005-07; 14.9% in 2007-09; 12.4% in 2009-11; and 16.3% in 2011-13.³³

Before 2004, both employees and employers contributed to Tier One and Tier Two pension plans. Determining the total yearly contribution to the plan required combining these contributions. From 1975 to 2005, these combined rates generally fell

³⁰ Ex. 34, p. 13.

³¹ Ex. 49, p. 13.

³² PERS actuarial valuations are done annually, but the valuation is used for purposes of setting employer contribution rates every other year (in the even-numbered years).

³³ Ex. 34, p. 19.

within the 15 to 18% range. With the 2003 legislation, commencing January 1, 2004 employee contributions were directed to the IAP account. Any comparison of current employer contribution rates, therefore, should take into account that employee contributions no longer add to the funding of Tier One and Tier Two plans.³⁴

6. *The Effect of the 2008 Recession*

As summarized above, from 2003 to 2007, the PERS Fund consistently earned more than the 8% assumption and as a result, funding of the plan increased until PERS funding reached 97.1% (111.5% with side accounts) by December 31, 2007. Employer contribution rates for the 2009-2011 biennium, which were based on the status of the fund on December 31, 2007, were on average 12.4% (4.73% with side accounts).³⁵

The 2008 economic recession changed things. As noted above, the PERS Fund suffered a loss of 27.18% in 2008, consistent with the losses suffered by pension funds throughout the United States due to the economic recession. The loss in 2008 negatively affected the “earnings” part of the general equation described above.

The 2008 recession first affected employer rates set by the PERS Board based on the December 31, 2009 valuation. Those rates went into effect on July 1, 2011. As noted above, the average employer contribution rates, system-wide, for the 2011-13 biennium

³⁴ Joint Stipulated Facts, pp. 20-21, ¶ 14.

³⁵ Joint Stipulated Facts, p. 20, ¶ 13.

were 16.3% (up from 12.4% in the previous biennium), or 10.8% with side accounts. This projected increase was limited by rate collaring.³⁶

PERS believed that rate increases of this magnitude might trigger legislative action. In preparation for the 2011 legislative session, PERS prepared an “Analysis of PERS Cost Allocation, Benefit Modification, and System Financing Concepts” dated December 1, 2010.³⁷

The 2011 Legislative Assembly enacted legislation based on at least one of those concepts.³⁸ By then, the economic recovery had begun. As noted above, the PERS Fund earnings were 19.12% in 2009 and 12.44% in 2010. The next legislation that significantly affected PERS was SB 822 and SB 861, enacted in 2013 and described more fully below.

7. 2013 Changes to Actuarial Methods and Assumptions

In mid-2013, the PERS Board selected methods and assumptions to be used in the December 31, 2012 and December 31, 2013 actuarial valuations. When compared to the assumptions and methods used in the previously-conducted valuation, the PERS Board made four notable changes. Those were (1) a reduction in the long-term average annual investment return assumption from 8.00% per annum to 7.75% per annum; (2) a change in the actuarial cost allocation method from Projected Unit Credit to Entry Age Normal;

³⁶ Joint Stipulated Facts, p. 21, ¶ 15.

³⁷ This analysis is included in the record as Ex. S1.

³⁸ See Ex. S1, p. 7 (describing legislative concept); 2011 Or Laws ch. 653, § 2 (now codified at ORS 238.372).

(3) a modification to the operation of the “Rate Collar” calculation which limits the magnitude of contribution rate changes from biennium to biennium; and (4) a decision to re-amortize the entire Tier 1/Tier 2 Unfunded Actuarial Liability (UAL) that existed as of December 31, 2013, over a twenty-year period as a level percent of projected payroll.³⁹

The PERS Board reviews its earnings assumption and other actuarial assumptions every two years in even-numbered years. Milliman (the Board’s actuarial firm) presents analysis of anticipated returns from their economic experts based on the asset allocation of the PERS Fund. In addition, the Oregon Investment Council (OIC) advisors provide their analysis of anticipated returns. These analyses are based on earnings expectations for each asset class. These projections are then adjusted to take into account several factors, including the volatility of the actual PERS Fund investments. Based on this information, the PERS Board lowered the earnings assumption of the Fund to 7.75%.⁴⁰

The changes in actuarial methods and assumptions will affect the retirement allowance for members who are active (not retired) as of January 1, 2014, and who ultimately retire and receive benefits calculated under the Money Match method. That calculation will result in a lower allowance amount because the factors are based on the reduced assumed rate of 7.75% instead of the prior 8% rate. The reduction in the assumed rate and the other changes in methods and assumptions will not change the amount of the system’s liabilities as of a particular valuation date. Rather, these changes

³⁹ Joint Stipulated Facts, pp. 15-16, ¶ 58.

⁴⁰ Joint Stipulated Facts, p. 25, ¶ 30.

only affect the amount and timing of the contributions necessary to fund the cost of the liabilities that were unfunded as of the valuation date.⁴¹

The changes in actuarial methods and assumptions were adopted by the PERS Board independent of changes resulting from SB 822 and SB 861. The PERS actuary would have recommended these changes to the PERS Board regardless of whether SB 822 or SB 861 had been enacted. These changes enhanced the benefit security of PERS members.⁴²

PERS has not calculated the discrete effects of each of the changes in methods and assumptions separately. In general, the projected employer rate reductions resulting from SB 822 are comparable in magnitude to the projected employer rate increases caused by the changes in methods and assumptions for the 2015-17 biennium. This was not planned; it is a coincidence.⁴³

C. History of Relevant Provisions Affected by the 2013 Legislation

1. *Cost of Living Adjustment (COLA)*

From 1964 to 1971, PERS retirement benefits were not adjusted for inflation. PERS retirees received additional payments in what has been referred to as a “13th check system.” PERS retirees received these additional checks based on the financial condition of the system. In 1964, this additional payment was equal to the retiree’s monthly

⁴¹ Joint Stipulated Facts, p. 16, ¶ 58 (a) and (b).

⁴² Joint Stipulated Facts, p. 17, ¶¶ 58 (c) and 59 (a).

⁴³ Joint Stipulated Facts, p. 17, ¶ 59 (b).

benefit. In 1965, the payment was 1.5 times the amount of the monthly benefit. In 1966 and 1967, it was 2 times the monthly benefit. In 1968-71, it was 3 times the monthly benefit. In December 1971, retirees received a one-time payment equal to 3.5 times the amount of their regular monthly benefit. These additional amounts were not added to the base amount of the retirees' benefits.⁴⁴

In 1971, the legislature enacted Oregon laws 1971, ch 738, §§ 11-12. That legislation provided that monthly retirement allowances payable on or after July 1, 1972, would be adjusted annually to reflect the increase or decrease in the cost of living as reflected by the Consumer Price Index for Portland (CPI), up to a maximum increase or decrease of 1.5 percent of the monthly retirement allowance. This adjustment is commonly known as a "cost of living adjustment" or COLA. Effective January 1972, the legislature also granted an *ad hoc* benefit increase of 25% for retirees who retired before January 1968, and 12% for retirees who retired after December 1967 and before January 1972.⁴⁵

The maximum COLA was increased to 2.0% effective July 1973; it remained at 2.0% until the enactment of SB 822 in 2013.⁴⁶ Before SB 822's enactment, the COLA provisions provided for a carryover or "bank." When the CPI is greater than 2%, retirees would receive a 2% COLA and the difference between the CPI and 2% is carried forward

⁴⁴ Joint Stipulated Facts, p. 29, ¶ 41; Ex. 48, p. 3.

⁴⁵ Ex. 48, pp. 2-3.

⁴⁶ There were some exceptions to the 2.0% "cap" on COLA increases. Those exceptions are shown in Ex. 48, p. 3.

in a “bank” to be used in future years when the CPI was less than 2%. While varying year to year, in most years since 1971, the CPI has been over 2%. In some years, the CPI has been below 2%.⁴⁷ As a result, as shown below in the section on “Petitioner-Specific Information,” most retired petitioners have a COLA carryover or “bank.”⁴⁸

The Oregon legislature granted additional *ad hoc* benefit increases during the 1970’s and 1980’s, which were periods of relatively high inflation.⁴⁹ In recent years, the PERS actuary has prepared an annual “Purchasing Power Study” designed to “compare how well monthly benefits paid to retirees and beneficiaries have kept up with inflation since retirement.”⁵⁰ As stated in the most recent study, the “current purchasing power of retirees depends on both the automatic COLA increases and the ad hoc increase granted, compared to the growth in the CPI over the same time period.”⁵¹

2. SB 656/HB 3349 Benefits

The history of the SB 656/HB 3349 benefits before SB 822 was enacted is described in *Stovall*, 324 Or at 98-104.⁵² This report adopts and incorporates that

⁴⁷ Joint Stipulated Facts, p. 29, ¶ 50. PERS’ current inflation assumption, developed by the PERS actuary and approved by the PERS Board, is 2.75%. See Ex. 32, p. 40; Ex. 48, attachment A.

⁴⁸ The COLA carryover or “bank” is explained in Ex. 48, p. 2.

⁴⁹ The details of the benefit increases are shown in Ex. 48, p.4.

⁵⁰ Ex. 21 (2012 Purchasing Power Study), p. 1; Ex. 48 (2013 Purchasing Power Study), p. 1.

⁵¹ Ex., 21, p. 4; Ex. 48, p. 4.

⁵² The PERS Actuary summarized the background of the SB 656/HB 3349 benefits in Ex. 20, p. 2.

description. Legislation enacted in 2011 eliminated SB 656/HB 3349 benefits for members who retire on or after January 1, 2012 and reside outside Oregon.⁵³

PERS estimates that the State of Oregon collected the following amounts in income taxes on PERS retiree benefits: \$105 million in 2007; \$117 million in 2008; \$125 million in 2010; \$136 million in 2011; and \$141 million in 2012.⁵⁴ According to a report by the National Institute on Retirement Security, Oregon's marginal state income tax rate on pension income in 2012 was 7.67%, the highest rate in the nation.⁵⁵

VI. THE 2013 LEGISLATION: SB 822 AND SB 861

A. Before Enactment: The December 31, 2011 Actuarial Valuation, Other Actuarial Estimates, and PERS' Analysis of Possible Legislative Concepts

PERS' actuary presented a summary of the system-wide results of its December 31, 2011, actuarial valuation to the PERS Board on August 28, 2012.⁵⁶ That valuation would be the basis for setting employer contribution rates for the period July 2013 through June 2015. The valuation resulted in the calculation of average employer contribution base rates of 21.4% of payroll (collared) for 2013-15. This represented a 5.1% increase from the 2011-13 collared rates. The uncollared rates for 2013-15 were

⁵³ 2011 Or Laws chapter 653, § 2.

⁵⁴ Those figures are reported in "PERS: By The Numbers." Ex. 25, p. 18; Ex. 34, p. 20; Ex. 70, p. 18; Ex. 71, p. 18; and Ex. 72, p. 19.

⁵⁵ Ex. S5, p. 2.

⁵⁶ The power point presentation summarizing that valuation is included in the record as Ex. 18. The actuarial valuation itself, dated October 26, 2012, is in the record as Ex. S3.

23.7% of payroll. System-wide net rates (reflecting offsets due to side accounts) were 15.7% (collared) and 18.0% (uncollared) for 2013-15.⁵⁷

The valuation also showed a decline in the funded status of the PERS fund as of December 31, 2011 that was attributed to lower than assumed investment returns, especially the 2008 losses. The valuation concluded that the PERS fund had an unfunded actuarial liability (UAL) of about \$16 billion. The system was considered 82% funded (including side accounts) and 73% funded (excluding side accounts) as of December 31, 2011, down from 87% funded (including side accounts) and 78% funded (excluding side accounts) as of December 31, 2010.⁵⁸

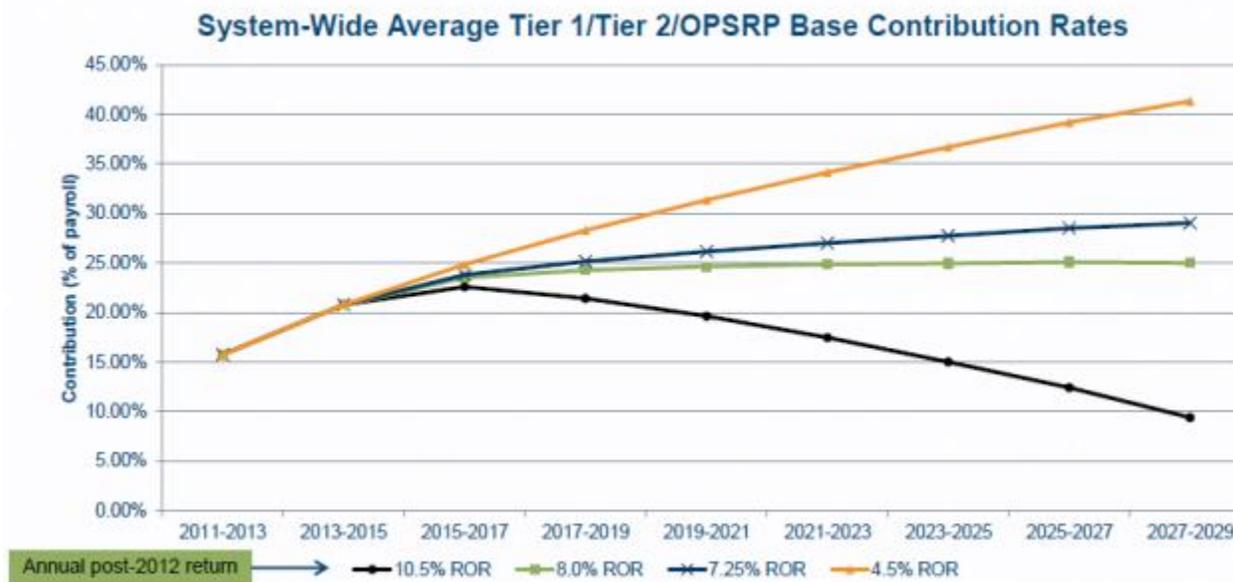
In a November 30, 2012 presentation to the PERS Board, the PERS actuary presented a chart (shown below) that projected system-wide average base employer contribution rates into the future based on the December 31, 2011 actuarial valuation and various earnings assumptions.⁵⁹ If actual earnings were 8% (the assumed rate at the time), the projected system-wide average base employer contribution rates would rise to nearly 25% by 2017-19, and remain at that level through 2027-29, as shown below.⁶⁰

⁵⁷ Ex. 18, p. 17 (slide 16).

⁵⁸ Ex. 18, p. 22 (slide 21).

⁵⁹ That presentation is in the record as Ex. 22. The projected employer contribution rates are shown on page 8 of that exhibit (slide 7).

⁶⁰ The projected rates would be higher if earnings were less than 8.0%, and lower if earnings were greater than 8.0%. See Ex. 22, p. 8.



PERS staff believed that, in light of the December 31, 2011 actuarial valuation, the Legislative Assembly likely would consider ways to reduce the increasing upward pressure on employer contribution rates and address the decline in the funded status of the PERS Fund. In preparation for the 2013 legislative session, PERS asked its actuary to estimate the system-wide average effects of eliminating SB 656/HB 3349 benefits for all PERS retirees who reside outside Oregon. The actuary’s report, dated November 8, 2012, concluded that elimination of those benefits would decrease average employer rates system-wide rates for the 2013-15 biennium by 0.3%, thereby reducing employer contributions to the system by about \$55 million for the biennium.⁶¹

PERS also prepared an “Analysis of PERS Cost Allocation, Benefit Modification, and System Financing Concepts” dated February 14, 2013, in connection with the 2013

⁶¹ Joint Stipulated Facts, p. 23, ¶ 18. The actuary’s November 8, 2012 report is included in the record as Ex. 20. The actuary’s November 30, 2012 presentation to the PERS Board is included in the record as Ex. 23.

legislative session.⁶² This report was similar to and updated the analysis PERS had prepared before the 2011 legislative session.⁶³ The analysis included various potential cost containment concepts that might form the basis for legislation.

PERS also asked its actuary to estimate the system-wide effects of the modifications proposed in SB 822. In a report dated March 28, 2013, the actuary estimated that the benefit reductions in SB 822 would reduce the total liabilities of the system by \$3.2 billion, and reduce accrued liabilities of the system by \$2.6 billion. Both sums were expressed on a present value basis. The report further estimated that projected uncollared employer contribution rates would be reduced by 2.5% in the 2013-15 biennium. The report also indicated that the projected \$3.2 billion reduction in total liabilities represented a 4.6% reduction from the December 31, 2011 valuation. The percent reduction varied by individual member. The weighted average decrease for current active members was 4.9%; for current inactive members, 3.2%; and for current retirees, 4.5%.⁶⁴

In a report dated September 18, 2013, the PERS actuary estimated the system-wide average effects of the COLA modifications proposed in SB 857. That bill had the

⁶² The analyses prepared before the 2013 legislative session is included in the record as Ex. S2.

⁶³ The analysis prepared before the 2011 legislative session is included in the record as Ex. S1.

⁶⁴ The actuary's March 28, 2013 report is included in the record as Exhibit 27.

same COLA reductions as the reductions ultimately enacted in SB 861.⁶⁵ The actuary’s report projected that the COLA reductions would reduce the UAL by an additional \$2.1 billion and would reduce uncollared base employer contribution rates by an additional 2% for the 2013-15 biennium.⁶⁶

B. Enactment of SB 822 and SB 861

1. Summary of the Legislation

SB 822 reduced the limitation, or “cap,” on COLA from 2.0% to 1.5%, effective August 1, 2013. Effective July 1, 2014, SB 822 provides for an annual COLA as described in the following chart:

Annual Benefit Amount	Applicable COLA
First \$20,000	2.00%
\$20,000 to \$40,000	1.50%
\$40,000 to \$60,000	1.00%
\$60,000 or more	0.25%

The PERS actuary prepared this chart, and said that the change in COLAs “will be most pronounced for members with larger benefits.”⁶⁷

⁶⁵ The actuary’s analysis of SB 857 did not include the supplemental payments provided by SB 861, described below. Joint Stipulated Facts, p. 26, ¶ 32.

⁶⁶ The actuary’s September 18, 2013 report is included in the record as Ex. 37.

⁶⁷ Joint Stipulated Facts, p. 24, ¶ 25.

SB 822 also eliminated the SB 656/HB 3349 benefit increases effective January 1, 2014 for any benefit recipients who are not subject to Oregon personal income tax because they do not reside in Oregon.⁶⁸

SB 822 required the PERS Board to recalculate the contribution rates of all employers, and to issue corrected contribution rate orders to employers affected by the recalculated rates within 90 days. A budget note to SB 822 directed the PERS Board to delay imposing up to 1.9% of the projected employer contribution rate increase until the 2015-17 biennium.⁶⁹

SB 861 supersedes the COLA changes adopted in SB 822 beginning August 1, 2014 and thereafter. SB 861 lowered the COLA according to the following chart⁷⁰:

Yearly Benefit	Senate Bill 822 COLA (No longer in effect after approval of SB 861)	Senate Bill 861 (*Ends in 2019)		
		COLA	First Supplemental payment for all benefit recipients*	Second Supplemental payment for benefit recipients whose yearly benefit is \$20,000 or less*
<\$20,000	2.00%	1.25%	0.25%	0.25%
\$20,000-\$40,000	1.50%			---
\$40,000-\$60,000	1.00%			
>\$60,000	0.25%	0.15%	\$150	

⁶⁸ Joint Stipulated Facts, p. 24, ¶ 26.

⁶⁹ Joint Stipulated Facts, pp. 24-25, ¶ 27.

⁷⁰ Joint Stipulated Facts, p. 26, ¶ 33. The COLA changes and supplemental payments provided by SB 861 are summarized in Ex. 40.

SB 861 requires the PERS Board to pay the annual supplementary benefit payments out of the PERS contingency reserve beginning in 2014, sets out a tiered formula for calculating the supplementary payments (shown in the chart above), and limits the amount of any annual supplementary payment to no more than \$150. The supplemental payments are estimated to cost \$65 million for the six-year period (2014-2019). The balance in the contingency reserve as of December 31, 2013 was \$667.7 million. The contingency reserve balance is not taken into account in setting employer contribution rates, so the SB 861 supplemental payments are not expected to have any immediate effect on employer contribution rates.⁷¹

2. Effect of SB 822 and SB 861 on Employer Rates and UAL

At its May 31, 2013 meeting, the PERS Board directed its actuary to reduce employer contribution rates set as a result of the December 31, 2011 actuarial valuation by 2.5% effective July 1, 2013. That reduction reflected the liability reductions projected as a result of SB 822 and the budget note to that bill. Revised rate orders were issued to PERS employers based on that action. Those rates went into effect on July 1, 2013, and are the rates in effect for the 2013-15 biennium.⁷² The reduced rates were expected to

⁷¹ Joint Stipulated Facts, pp. 26-27, ¶¶ 34-35.

⁷² The PERS Board did not order further rate reductions after enactment of SB 861. It determined that any rate reductions for 2013-15 resulting from SB 861 were already taken into account because of the reductions previously adopted by the PERS Board in response to the SB 822 budget note. Joint Stipulated Facts, p. 27, ¶ 35.

produce an estimated \$810 million in system-wide savings for public employers during the 2013-15 biennium.⁷³

After enactment of SB 822 and SB 861, the PERS actuary recalculated advisory projected system average base employer rates.⁷⁴ That recalculation show an average employer collared base rate of 18.7% (12.5% including side accounts). Collaring has deferred approximately 2% of additional increases, though the 2013 returns of 15.95% are expected to reduce the collared amount. The 2008 losses, which triggered the rate collar, are not projected to have any further effect on employer rates through the rate collar.⁷⁵

On November 22, 2013, the PERS actuary presented a chart to PERS similar to the one he provided a year earlier leading-up to the 2013 legislative session. The chart included all of the PERS Board's changes from the 2012 actuarial valuation as well as 2012 and a substantial part of 2013 earnings (through October 31, 2013). The chart shows rates topping out at approximately 18% and if earnings are at the now-assumed rate of 7.75%, rates trending downward to approximately 13% over the next 8 biennia. As shown in the 2012 chart, higher earnings than the assumption cause rates to decrease more quickly and earnings lower than the assumption cause rates to increase. The chart

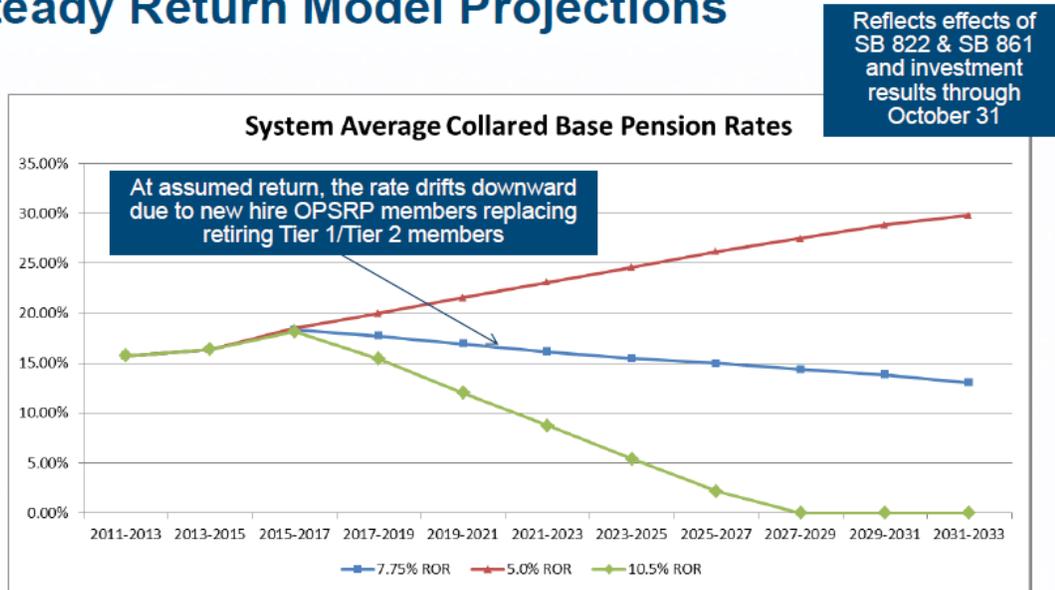
⁷³ Joint Stipulated Facts, p. 11, ¶ 23 (a).

⁷⁴ The rates in the December 31, 2012 actuarial valuation are considered “advisory” because the PERS Board did not order rate adjustments based on that valuation, consistent with its practice of adjusting employer contribution rates every other year. Exhibit 41 is the actuary’s November 22, 2013 presentation to the PERS Board on the December 31, 2012 advisory valuation.

⁷⁵ Joint Stipulated Facts, p. 27, ¶ 36.

itself (shown below) attributes the downward trend in rates to the fact that new hire OPSRP members are replacing retiring Tier I and Tier II members.⁷⁶

Steady Return Model Projections



The steady rate model illustrates impact of consistently achieving the assumed 7.75% return compared to plus or minus 2.75% of that rate

The total effect of the changes in projected contributions to be paid by public employers due to SB 822 and SB 861 is estimated to be about \$5.3 billion, stated on a system-wide, present value basis using the assumptions and methods adopted by the PERS Board in 2013 (summarized above).⁷⁷ The effect on respondents' employer contribution rates is set forth below in the section on "Respondent-Specific Information."

Taken together, SB 822 and SB 861 reduced the PERS UAL because the legislation reduced the amount of benefits projected to be paid to members in the future.

⁷⁶ Joint Stipulated Facts, p. 28, ¶37. The chart is included in the record on p. 17 of Ex. 41 (slide 16).

⁷⁷ Joint Stipulated Facts, pp. 11-12, ¶27.

Those liability reductions were estimated to total about \$5.3 billion, stated on a system-wide, present value basis. The PERS UAL as of December 31, 2013 is estimated to be about \$8.1 billion (excluding side accounts), and \$2.2 billion (including side accounts), taking into consideration the combined effect of SB 822, SB 861, and system earnings for 2012 and 2013 that exceeded the assumed earnings rate of 8%. PERS is estimated to be 87% funded (excluding side accounts) and 96 % funded (including side accounts) as of December 31, 2013.⁷⁸

3. Effect of SB 822 and SB 861 on Benefits

The effect of the changes in projected benefits to be paid to PERS members due to SB 822 and SB 861 is estimated to total \$5.3 billion, stated on a system-wide, present value basis.⁷⁹ The effect on petitioners' benefits is set forth below in the section on "Petitioner-Specific Information."

SB 822 and SB 861 change the COLA as stated in the bills. PERS staff estimates that COLA changes will result in a savings of \$60 to \$70 million in benefits projected to

⁷⁸ These figures take into consideration earnings for 2012 and 2013, which exceeded the assumed rate. The UAL and funded status of the system as of December 31, 2013 is stated in "PERS Facts" dated January 2014. That document is included in the record as Ex. 44. The December 31, 2012 actuarial valuation (dated December 13, 2013) shows the funded status of the PERS system and projected UAL and employer contribution rates (advisory) as of December 31, 2012 after taking into consideration the enactment of SB 822 and SB 861. The valuation is included in the record as Ex. 43. The actuary's November 22, 2013 presentation to the PERS Board on that valuation is included in the record as Ex. 41. *See also* Joint Stipulated Facts, p. 29, ¶ 38.

⁷⁹ Joint Stipulated Facts, p. 11, ¶ 26.

be paid through 2015.⁸⁰ The PERS actuary analyzed the effect the SB 822's COLA changes will have on retirees' purchasing power.⁸¹ The actuary has not conducted a similar study on the effect SB 861's COLA changes will have on retirees' purchasing power.

PERS publishes a "Replacement Ratio Study" that shows retirees' monthly benefits as a percentage of their final salaries at retirement.⁸² PERS believes that the most recent Purchasing Power and Replacement Ratio studies show that (1) members who retired in the mid- to late-1990s and after have a relatively higher replacement ratio than other retirees, and have not seen the purchasing power of their benefits erode as much as members who retired previous to that time; and (2) a COLA reduction would not, over time, erode the purchasing power of benefits paid to members who retired after the late 1990's below that experienced by members who retired earlier and those who have yet to retire.⁸³

SB 822's elimination of SB 656/HB 3349 benefits for retirees who reside outside Oregon affected 16,546 recipients, 14% of all benefit recipients.⁸⁴ This amounted to a

⁸⁰ That estimate is included in a report to the PERS Board dated January 31, 2014. *See* Ex. 47, p. 3.

⁸¹ That Purchasing Power Study is in the record as Ex. 48.

⁸² The results of the most recent Replacement Ratio Study are in the record at Ex. 49, p. 5.

⁸³ Ex. S26 (Rodeman Dec.), ¶21; Ex. 48; Ex. 49, pp. 4-5.

⁸⁴ PERS coordinated with the Oregon Department of Revenue to implement this change. If a retiree living outside Oregon moves back to Oregon, PERS restores the SB 656/HB

system-wide benefit reduction of \$2,235,617 per month. This reduction represented 6.097% of benefits otherwise paid to this population, who received a total of \$34,417,234 per month after these reductions.⁸⁵ PERS staff estimates that the elimination of SB 656/HB 3349 benefits will result in a savings of about \$60 to \$70 million through 2015.⁸⁶

The combined effect of changes in projected member benefits due to SB 822 and SB 861, and 2013 PERS Board decisions regarding assumptions and methods to be used in calculating liabilities and contribution rates, yields a \$5.1 billion present value (as of July 1, 2013) decrease in projected employer contributions for the twenty-year period from July 2013 – June 2033. Additional projected contribution savings subsequent to June 2033 are also anticipated due to the SB 822 and SB 861 changes.⁸⁷

The liability reductions from SB 822 and SB 861 are realized by lowering the amount of benefits to be paid to active, inactive, and retired PERS members over time. The COLA changes in SB 822 and SB 861 are spread across a broad base of members, including retired and inactive members, the subset that comprises the largest proportion of the system's UAL. Because almost all PERS members receive a COLA, the benefit

3349 benefits effective January 1 of the following year. Ex. S26 (Rodeman Dec.), ¶¶ 23-24.

⁸⁵ Ex. S26 (Rodeman Dec.), ¶¶ 25, 32.

⁸⁶ Ex. 47, p. 3.

⁸⁷ Joint Stipulated Facts, p. 13, ¶ 31.

change, on average, is less than a benefit change affecting fewer members that reduces liabilities to the same extent as SB 822 and SB 861.⁸⁸

Alternative benefit changes that were considered would have affected a narrower segment of the PERS member population. Benefit changes affecting a small number of members would have to have a much greater impact on each affected member, in order to achieve the same level of UAL reduction and corresponding reduction in employer contribution rates that the COLA change did.⁸⁹

VII. ECONOMIC HARDSHIP DEFENSE

The parties presented evidence from fact and expert witnesses regarding the economic hardship defense asserted by the School District Respondents, Linn County, and Intervenor Oregon School Boards Association and Association of Oregon Counties. Evidence relating to the economic conditions of the School District Respondents and Linn County is set forth below in the section on “Respondent-Specific Information.”

The proponents of the economic hardship defense rely primarily on the testimony of John Tapogna, president of ECONorthwest, an economic and financial consulting firm, and Curtis Robinhold, Chief of Staff for Oregon Governor John Kitzhaber during 2012 and 2013.⁹⁰ A coalition of organizations⁹¹ retained Tapogna’s firm during the 2013

⁸⁸ Ex. S26 (Rodeman Dec.), ¶ 17.

⁸⁹ Joint Stipulated Facts, p. 13, ¶ 33.

⁹⁰ Tapogna and Robinhold testified by declaration submitted in lieu of direct examination and supplemented their testimony at the evidentiary hearing. Tapogna’s declaration and report is Ex. SDLC 101. Robinhold’s declaration is Ex. SDLC 102.

legislative session to develop presentations for legislators, staff, and others that described PERS' financial condition and outlined possible policy responses. As the Governor's Chief of Staff, Robinhold was involved in preparing the Governor's proposed budget for the 2013-2015 biennium and in formulating the legislative concepts that were ultimately enacted as SB 822 and SB 861.

The Moro petitioners submitted a report from Thomas Potiowsky, Ph.D., a professor of economics at Portland State University who served as the State Economist for Oregon from 1999-2006 and 2008-2011. Potiowsky provided an overview of Oregon's revenue system with particular emphasis on the state's status in 2013. He also provided information on the tax burden in Oregon in comparison with other states, and provided specific analysis on K-12 educational funding in Oregon.⁹²

The evidence from Tapogna, Robinhold, and Potiowsky is summarized below. Details are found in their declarations, testimony, and reports included in this record.

A. Economic Conditions In General

Oregon's economy tends to be more volatile through the business cycle compared to the nation as a whole. With Oregon's relative concentration in durable manufacturing, from electronics to wood products, the Oregon economy tends to grow faster during expansions and fall deeper into recession during contractions of the national economy. Of all the tax bases, income tends to be the most volatile source through the business

⁹¹ The organizations were STAND for Children (Oregon Chapter); the Oregon Business Association; the Oregon School Boards Association; and the Oregon Business Plan.

⁹² Potiowsky's report is in the record as Ex. 73.

cycle. This combination places Oregon in the position of having general fund revenues that are difficult to predict and move in a very wide band.

In comparing changes in employment from the start of each of the economic recessions suffered by the state of Oregon back to 1948, the 2008 recession had a total job drop of slightly more than 8% while the 1980 recession had a total job loss of almost 12%. The expected length of time to recover these lost jobs is likely to be similar to what took place in the 1980s. Job loss recovery has been very slow but steady; it is predicted that Oregon will recover lost jobs by early to mid-2015. Unemployment changes show a similar picture.

Income taxes tend to be more volatile compared to sales and property taxes. Oregon relies on personal income taxes more than any other state. With this combination of a more volatile economy and a more volatile tax base, general fund revenues can rise rapidly in recoveries and fall steeply in economic downturns.

With personal income taxes making up 85% of the general fund revenues, state funding is very much influenced by the business cycle. General fund revenues tend to fall during recessionary periods. This places constraints on all services provided by the state.

Downturns in the business cycle cause state general fund revenues to decline. In the last recession it took more than four years to get back to the same level of general fund revenues. Comparing the December 2007 projection to actual revenues, Oregon collected \$8.3 billion less for the general fund between the 2007-2009 and 2011-2013

biennia. For both 2009-11 and 2011-13, actual general fund revenues were more than \$3 billion (20%) less than predicted in December 2007.

Although Oregon is considered a high tax state when looking only at personal income tax, the same cannot be said when comparing Oregon to other states when looking at all general fund revenue. Oregon is a relatively lower tax burden state in comparison with others, with taxes 11.8% lower per capita than the U.S. average. Oregon is ranked 33rd for state taxes as a percentage of personal income. State taxes as a percentage of state productivity show Oregon as 14.8% below the national average.

State funding for public safety has increased faster than population growth. Public safety funding for the Department of Corrections has increased due to expanding prison populations. The prisoner population more than doubled since the passage of Measure 11; today, more than 14,000 people are imprisoned by the State of Oregon. Spending on human services has also outpaced population growth. This includes spending on the Oregon Health Plan and other Department of Human Services programs.

While the recent recession has been dubbed the “Great Recession” for the United States, Oregon’s Great Recession was in the early 1980s. At that time job losses reached almost 12%, while the recent recession has resulted in job losses of slightly more than 8%. The highest seasonally-adjusted unemployment rate for Oregon in the early 1980s was 12.1% in 1982. The highest seasonally-adjusted unemployment rate during the recent recession was 11.6%.

The economic recovery will be reaching its fifth year heading into late summer-early fall, 2014. Job growth has been steadily climbing, reaching 2% growth in April

2013 and now is growing faster than the U.S. job growth rate. For all of 2013, Oregon had the third fastest job growth of the 50 states.

Job growth in Oregon accelerated in 2013. Similar to the United States as a whole, this was largely due to improvements in the housing market and public sector employment. As a result, more regions of the state began adding jobs. Looking forward, growth is expected to continue a bit further, into the 40,000 jobs per year range, or an annual growth rate of 2.4 percent in 2015.

Better economic times have translated into higher general fund tax revenues. The 2013-15 general fund budget was 14% higher than the budget for the prior biennium. This is a significant increase relative to past biennia. The increase between the two biennia is largely due to \$1.9 billion more in general fund resources being authorized for expenditure in the 2013-15 biennium than were spent in 2011-13. This 14% increase in general fund expenditures is the largest percentage increase since a 14.9% increase in the 1999-2001 biennium.

The current forecast for general fund revenues is for continued growth, though not as strong as we have seen from some previous recoveries. Current projections show 10.9% growth for 2015-2017 general fund revenue (\$1.711 billion more than 2013-2015), 8.6% growth in 2017-2019 (\$1.507 billion more than 2015-2017) and 9.8% growth for the 2019-2021 General Fund revenue (\$1.868 billion more than 2017-2019).

The personal income tax “kicker” will occur if personal income taxes plus all other general fund revenues except for corporate income taxes increase 2% or greater for the biennium compared to the close of session (COS) estimate for that biennium. The

kicker is a refund to personal income taxpayers of the amount that is above the COS estimate once the 2% threshold is obtained. As of the March 2014 forecast for general fund revenues, the personal income tax kicker would be triggered by an additional revenue increase of \$100 million, as the forecast is currently 1.3% above the COS estimate.

B. Public School Financing

Property taxes are the primary source of funding in Oregon for local governments. As explained below, three ballot measures passed by Oregon voters--Measures 5, 47 and 50—limit property tax increases and make the state responsible for replacing lost funding to K-12 school districts. Prior to Measure 5, about two-thirds of school funding came from local property taxes. After the Measure 5 changes were phased in, about two-thirds of school funding now comes from the state. This shift moved K-12 school district funding from a relatively stable funding source of property taxes to the more volatile income taxes.

Measure 5 (1990) put caps on the maximum property tax rates. At the beginning of the 1990s, the average rate was about \$27 per \$1,000 of real market value. Now the average effective rate is about \$12 per \$1,000 of real market value.

Measure 47 was passed in 1996 and amended by Measure 50 in 1997. These measures suppressed the value at which property would be assessed. Measure 50 changed the way property is assessed for taxation, lowering the assessed value and limiting the annual growth in assessed value, which ensured that assessed value would not grow as fast as real market value. Over time, the difference between real market

value and assessed value has increased, even after accounting for reductions in market values after the housing bubble burst.

Combined with the cap on tax rates, limits on assessed values means that, over time, property taxes are increasingly limited in the amount of revenue they are able to raise. Together, Measures 5 and 50 effectively caused a \$13 billion reduction in property taxes in the 2011-2013 biennium statewide.

After the Measure 5 changes were fully phased in, the amount of state general fund/lottery fund funding for education has remained relatively flat while inflation-adjusted spending for human services and public safety has increased. While state education funding has stayed relatively constant, the state population has grown. That means less real money is spent per person for education over time. If inflation-adjusted state general fund/lottery fund spending on education had increased at the same rate as population growth instead of staying flat, about \$4.25 billion more in state funding would have gone to K-12 education between 1999-2001 and 2013-2015.

Oregon invests less in education than nearly every other state as a percent of the total state budget. In 2012, only Maine and Wyoming spent a smaller percentage of their state budgets on education than Oregon.

The 2013-15 Oregon budget allocates \$6.55 billion to K-12 education, compared to \$5.714 billion allocated for the 2011-13 biennium. It was estimated that \$6.315 billion—an increase of about \$601 million from the last biennium—was needed to maintain service levels at the same levels as the 2011-13 biennium. The allocated

increase for 2013-15 above 2011-13 was \$836 million, or around \$235 million more than the amount needed to maintain current service levels for K-12 education.

C. Perceived Need for PERS Reform

1. *Relative Financial Condition of Oregon's Public Pension System*

The PERS actuary's December 31, 2011 valuation signaled a long term increase in employer contribution rates. The valuation recommended increases in PERS' Tier I and Tier II contribution rates, net of side account offsets, averaging 6.5% for school districts and 4.5% for agencies in the state and local government pool. The actuary predicted that average base employer contribution rates would increase to 25% of payroll under the baseline investment return assumption of 8% per year, and that the elevated rates could persist through 2029. If future investment returns yielded a lower return of 4.5% annually, the actuary predicted base employer contribution rates eventually could exceed 40% of payroll.

In June, 2012, the Pew Center on the States issued "The Widening Gap Update," which reported a \$1.38 trillion gap between states' pension assets and their obligations for public sector retirement benefits for fiscal year 2010.⁹³ Pew reported Oregon's funded status for its state-sponsored plan at 87 percent for fiscal year 2010. Based on the funded status, Pew placed Oregon's system in the category of "needs improvements," but considered Oregon's system in better condition than those of 34 states with funded statuses below an 80 percent threshold.

⁹³ Excerpts from the Pew Center report are included in the record as Exs. 78 and 79. The Pew report is cited and described in Tapogna's report, Ex. SDLC 101, p. 8.

An October 2012 “Public Pension Funding Study” by Milliman measured the aggregate funded status of the 100 largest public pension plans in the United States. That study concluded that, using current market values of assets and current views on investment returns, those plans have assets of \$2.513 trillion and accrued liabilities of \$3.706 trillion, resulting in aggregate underfunding of \$1.193 trillion and an aggregate funded ratio of 67.8%.⁹⁴

On October 1, 2012 the University of Chicago’s IGM Forum reported survey responses of 39 leading U.S. economists demonstrating concern about the condition of public pension systems. The economists served on the faculties of top universities, including Harvard, Yale, Stanford, University of California at Berkeley, University of Chicago, and MIT. Ninety-eight percent of the respondents agreed or strongly agreed that many state and local governments understate their pension liabilities by discounting liabilities at high rates under government accounting standards. Ninety-two percent of respondents agreed or strongly agreed that during the next two decades, some states, unless they substantially increase taxes, cut spending, and/or change public sector pensions, will require a combination of severe austerity budgets, a federal bailout, and/or default.⁹⁵

⁹⁴ Ex. 19, p. 1.

⁹⁵ This survey is described and cited in the Tapogna report, Ex. SDLC 101, p. 9. In response to this survey, the Moro petitioners submitted an article by Paola Sapienza and Luigi Zingales titled “Economic Experts vs. Average Americans.” That article is included in the record as Ex. 76.

In September, 2012, Robert Novy-Marx and Joshual Rauh co-authored *The Revenue Demands of Public Employee Pension Promises*, which provided calculations of the increases in employer contributions that would be required to achieve fully funded pensions systems in 30 years.⁹⁶ Each state's contribution increases are calculated relative to a base of Gross State Product.

Novy-Marx and Rauh concluded that, under their amortization and asset growth assumptions, Oregon faced one of the most challenging paths in the nation to fully funding its pension liability. They simulated that, if Oregon raised taxes or reduced public services by amounts required to fully fund an unchanged pension system, the tax burdens or service cuts would become so burdensome that "residents flee at a rate that makes paying the benefits impossible." The simulation of Oregon's population exodus is driven by a high level of required contributions relative to the size of the state's economy measured by Gross State Product. In addition, the paper presents the equivalent of a stress test of the nation's public pension systems. It illustrates that, in the event future investment returns were weaker than the actuary's baseline investment projections, Oregon's pension system would face challenges that are large relative to other states' systems.

In response to the Novy-Marx and Rauh articles, the Moro petitioners submitted an article from the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR) that is critical of the Novy-

⁹⁶ The Novy-Marx and Rauh report is described and cited in the Tapogna report, Ex. SDLC 101, pp. 10-12. The actual report is included in the record as Ex. 80.

Marx and Rauh analysis. The NASRA/NCTR article concludes that Novy-Marx and Rauh’s conclusions “bear little resemblance to the actual practices of most state and local governments, or the pension plans, and again have limited application for policymakers wishing to address the financial impacts of the Great Recession.”⁹⁷

The design and implementation of the Tier I Money Match program was an important, structural contributor to the system’s financial challenges. Employees who retired with 30 years of service in the late 1990’s and after receive elevated replacement ratios relative to outcomes that would have resulted from application of the Full Formula. This phenomenon is documented in the 2004 Special Master’s report, in periodic reports from PERS, and in an analysis of the PERS data released to the Oregonian regarding individual retirement benefits between 2000 and 2011.⁹⁸

A May, 2013 report issued by Portland State University’s Center for Public Service provided additional evidence of the atypical outcomes produced by the Money Match benefit.⁹⁹ The report compared Money Match outcomes to those that would have been earned for identically compensated work in other jurisdictions in the region. The report modeled pension outcomes for archetypical employees—retirees with 30 years of service, under alternative plans.

⁹⁷ Ex. 75, p. 1.

⁹⁸ *See* Ex. SDLC 101, p. 13.

⁹⁹ The PSU report is described and cited in the Tapogna report, Ex. SDLC 101, p. 14.

For example, an analysis of Portland-based K-12 teachers compared Money Match outcomes to benefits that would have been earned in public schools in Seattle and Boise. A teacher with 30 years of continuous service and retired under Money Match on July 1, 2013 received retirement benefits worth \$1.676 million calculated present value. Seattle and Boise counterparts received benefits worth \$1.064 million and \$1.116 million, respectively. The PSU report also showed elevated retirement benefits for general service accountants. Inter-jurisdictional differences for police officers and state troopers were less pronounced. The report also shows that retirement benefits for the 2003-enacted OPSRP plan are similar to those that would be provided by the comparison jurisdictions.

Oregon's accrued liability for its state-sponsored retirement plan, expressed as a share of economic activity, is larger than Washington's. In fiscal year 2010, Pew reported Oregon's accrued liabilities for its state-sponsored plan at \$59.3 billion. For the same year, Pew reported Washington's accrued liability for its state-sponsored plans at \$61.7 billion. However, Washington's economy, measured by total personal income, was more than twice the size of Oregon's (Washington's equaled \$286.7 billion; Oregon's equaled \$137.7 billion).

In Oregon, sixty-percent of the system's accrued liability as of December 31, 2011 was associated with people who have already retired. Changes to the COLA and the out-of-state tax adjustment were options to reduce liabilities associated with the retiree population.

Ten percent of the system's accrued liability was associated with non-retirees—active and inactive—who were projected to exit under the Money Match calculation and with benefits above what would have been provided through the Full Formula.

A targeted public policy response intended to address the impact of the design and implementation of the Money Match formula on the system's accrued liabilities would focus on these populations of PERS retirees and members.

In 2013, the enactment of SB 822 as amended by SB 861 resulted in approximately \$368 million annually in additional resources for the current operation of school districts, cities, counties, state agencies, and other special purpose districts. With the change, a higher share of tax revenues can be devoted to supporting current services.

In the case of K-12 education, each percentage point reduction in the school district employer rate is the fiscal equivalent of 1.3 additional school days, implemented statewide. The reduction in employer contribution rates could translate into 5.6 additional school days, or could be used to hire additional teachers to bring down class sizes, to implement full day kindergarten, or for other targeted strategies to improve student achievement. Policies that seek to improve the quality of education services are especially important in a state such as Oregon with relatively high student-teacher ratios. The quality of education services is a key determinant in business location decisions.

Oregon communities along the Washington-Oregon border are at a competitive disadvantage with Washington communities. The Oregon school districts and local governments face higher employer contribution rates and legacy pension costs than their counterparts in Washington. As a result, Oregon's school districts and other governments

would deliver lower levels of service at a given level of taxation than their Washington counterparts.

Tax and service differences are important business location factors within an economic region. The passage of SB 822 as amended by SB 861 took a step toward mitigating the differences in employer contribution rates between Washington and Oregon public employers, and, thereby, took a step toward strengthening the economic competitiveness of communities in close proximity to Washington.

2. Governor's Office Perception

In the process of preparing the Governor's proposed budget for the 2013-2015 biennium, the Governor's Chief of Staff and others among the Governor's staff determined that under then-current assumptions—specifically, those required to be used by the state's own economists—Oregon faced, and would in coming years continue to face, a growing “budget gap” representing the divergence between available revenue and the revenue required to maintain existing service levels for essential state and local services, including public education. Those projections further indicated that two areas of public spending disproportionately drove the projected increases in that “budget gap”: health care spending, and the cost of maintaining PERS.¹⁰⁰

Among the materials relied upon by the Governor's staff in concluding that PERS costs would significantly contribute to Oregon's “budget gap” in coming years were several studies and presentations concerning PERS prepared from late 2011 through late

¹⁰⁰ Joint Stipulated Facts, p. 46, ¶ 36.

2012 by Milliman, the PERS actuary. To learn more, the Chief of Staff and others among the Governor's staff engaged in an ongoing dialogue with PERS, including its executive director Paul Cleary. The Governor's staff believed that the costs of maintaining PERS would continue to escalate, and that the Employer Contribution Rates necessary to support those costs would continue to increase. The Governor's staff concluded that the cost of maintaining PERS would be growing faster than the state's revenue, and that the resulting escalation in Employer Contribution Rates would increasingly adversely impact the ability of public bodies—and school districts in particular—to provide essential services to the public. They further concluded that those adverse impacts threatened to hinder Oregon's ability to compete economically with other states in the region for residents and businesses.

The Governor's staff also considered the apparent causes of the system's growing costs. In particular, they believed that the growing cost of PERS was in significant part attributable to the cost of benefits being paid to existing retirees, particularly those at the higher end of the economic spectrum—those receiving amounts well in excess of the income replacement ratios that the system was originally intended to provide—and to the annual cost-of-living adjustments that continued to escalate those retirees' benefits. They also believed that payments that had been created to compensate PERS retirees for Oregon state income taxes on PERS benefits, but which were being paid to retirees even if they resided outside of Oregon and paid no Oregon income taxes, also were

contributing to increasing PERS costs, though to a lesser extent than cost of living adjustments.¹⁰¹

Based on those assessments, it was decided in Fall 2012 that the Governor's efforts to improve Oregon's economy should focus substantially on addressing the growing cost of PERS and to helping control future increases in Employer Contribution Rates paid by school districts and other public bodies in the state. The Governor directed that his proposed budget for the 2013-15 biennium should be based upon the assumption that legislation would be enacted to reduce and control PERS costs. To achieve that goal, the Chief of Staff and others at the Governor's office sought out ways to address the aspects of PERS that they believed disproportionately contributed to the system's growing costs, including the amounts by which cost-of-living adjustments are made to existing retirees' benefits. The Governor's proposed budget assumed \$865 million in PERS savings.¹⁰²

The Chief of Staff and others among the Governor's staff proposed to Governor Kitzhaber that a legislative effort should be made to amend the laws governing certain aspects of PERS, including specifically the statutes governing COLA amounts and tax-offset payments to out-of-state retirees. The Chief of Staff and others among the Governor's staff believed that such a legislative effort would be a narrowly-focused solution to what had become a broad-based economic concern: In order to help alleviate

¹⁰¹ Joint Stipulated Facts, pp. 46-47, ¶ 38.

¹⁰² Joint Stipulated Facts, p. 47, ¶¶ 39, 39A.

the increasing difficulty Oregon's public bodies faced with providing essential services to the state, the Governor's legislative effort specifically targeted the individual elements of the retirement system that disproportionately drove the escalation in those public bodies' operating costs.

Over the course of the 2013 Regular Legislative Session and the Special Legislative Session that followed in the fall of 2013, the Chief of Staff and others among the Governor's staff worked with several legislators—particularly Joint Ways & Means Committee Co-Chairs Senator Richard Devlin and Representative Peter Buckley—to design and eventually promote passage of bills that implemented those PERS changes. Governor Kitzhaber supported those changes and signed SB 822 and SB 861 after they were passed by the legislature.

D. Summary of Expert Opinions

The opinions expressed by the two expert witnesses are summarized below. This report summarizes those opinions without adopting either opinion as recommended factual findings. The credibility of the expert witnesses is not at issue. The experts are well-qualified, and they expressed their opinions and conclusions sincerely. Their reports and testimony address different subjects without directly contradicting each other. In many ways, both experts' assessments may be correct. To the extent necessary, the Oregon Supreme Court can determine which aspects of the experts' testimony are more persuasive.

1. *John Tapogna*

The information made available to legislators in various presentations during the 2013 regular session indicated that the financial condition of Oregon's pension system warranted a policy response, in Tapogna's opinion. The Oregon legislature responded by changing PERS through the passage of SB 822 as amended by SB 861. This legislation reduced PERS' accrued liability for future pension payments.

Tapogna believes that the changes made by SB 822 as amended by SB 861 were justified by an important, significant, and legitimate public purpose of remedying a broad and general economic problem.

Specifically, in his view, the enactment of SB 822 as amended by SB 861 was justified so that Oregon's public agencies could provide levels of service quality, at given levels of taxation, that would be more comparable to those provided in Washington, Idaho, and other states that compete with Oregon for businesses and households.

Tapogna further explained that the public services provided for a given level of taxation is a factor in the location decisions of businesses and households, especially in intraregional contexts such as the Portland metropolitan area and other communities along Oregon's border with Washington. Whether businesses and households decide to locate in Oregon has economic ramifications.

While devoting a larger share of total personal income to education—by, for example, increasing taxes or reforming the way Oregon taxes its citizens—has the potential to improve outcomes by increasing overall resource levels, those changes would not address the underlying problems that increasing legacy pension costs impose on

Oregon's schools, in Tapogna's view. Rather, Oregon schools must improve productivity at a given resource level by devoting a larger share of expenditures to current services as opposed to financing legacy pension costs. Tapogna believes that the 2013 legislation furthered that goal by allowing a larger share of schools' expenditures to be devoted to current services rather than legacy pension costs.

In summation, Tapogna believes that the enactment of SB 822 as amended by SB 861 was justified as an effort to reduce the financial risk facing the state of Oregon and local governments within the state. In his view, the legislation was a justifiable response to strong warnings about pension financing from leading economists.

2. Thomas Potiowsky

Potiowsky explained that many state and local governments struggled during this last recession, and that providing adequate funding for K-12 education was part of this struggle. According to Potiowsky, Oregon has some unique factors that compound this challenge. Some of those factors are as follows:

- Demographic changes along with shifts in spending from an aging population will mean slower tax revenue growth relative to past periods. Oregon's general fund revenues are concentrated in personal income taxes. Combining a highly volatile tax with a highly volatile economy, makes revenue projections and expenditure planning difficult.
- Oregon moved the major funding for K-12 education from a more stable property tax base to the more uncertain personal income tax base.
- With K-12 education now dependent on state funding, it is in competition with public safety and human services for scarce resources.

- Oregon, by many measures, is a relatively low tax burden state and percent of budget spent on education is one of the lowest among the states.
- The underlying volatility of Oregon and its public finance system shows up in this recent recovery with faster job growth for Oregon compared to the nation and rapid growth in general fund revenues.

Changes to Oregon’s PERS benefits which lower employer contributions do not make any fundamental change to Oregon’s revenue system and ultimately will not resolve Oregon’s K-12 funding issue, according to Potiowsky. While changes to Oregon’s PERS benefits which lower employer contribution rates will lower the cost of services (as would cutting teacher’s salaries or larger classrooms with fewer teachers), Potiowsky believes that such changes do not address the fundamental issues underlying our tax revenue system for funding Oregon’s K-12 education.

VIII. PETITIONER-SPECIFIC INFORMATION

Eleven of the sixteen petitioners in these consolidated cases reside in Oregon. As Oregon residents, they are presently affected only by the COLA portion of SB 822 and by SB 861. Five of the sixteen petitioners reside outside Oregon. As out-of-state petitioners, they are presently affected by both the COLA provisions of SB 822 and SB 861, and by the elimination of SB 656/HB 3349 benefits provided by SB 822.¹⁰³

The parties submitted different estimates of the effects of SB 822 and SB 861 on projected benefits of individual petitioners. The Moro petitioners relied on the

¹⁰³ Joint Stipulated Facts, p. 13, ¶¶ 37, 49. PERS has over 122,000 benefit recipients and over 209,000 active and inactive members. Ex. 49, p.2. No party contends that the 16 petitioners in this case are a representative sample of the PERS member population as a whole.

calculations of their actuary, David MacLennan.¹⁰⁴ The self-represented petitioners relied on their own calculations.¹⁰⁵ Respondents relied on the calculations made by PERS staff.¹⁰⁶ There are two main differences between these approaches: (1) life expectancy assumptions; and (2) reduction to net present value.

The life expectancy assumptions used by MacLennan and PERS were only slightly different. The discount to present value resulted in larger differences in the calculations. MacLennan used expected benefit payments without reducing future payments to net present value. PERS' calculations reduced future benefit payments to net present value using a discount rate equal to the current assumed earnings rate of 7.75%.¹⁰⁷

This report includes both sets of calculations without attempting to determine which life expectancy assumptions should be used and without attempting to decide whether discounting future payments to net present value is required to accurately assess the effect of SB 822 and SB 861 on each petitioner.

¹⁰⁴ The MacLennan calculations are attached to the declarations of the individual petitioners included in the record as Exs. 3-14. MacLennan's methodology is explained in the exhibits attached to each declaration.

¹⁰⁵ Those calculations are included in the self-represented petitioners' affidavits, Exs. 61-63.

¹⁰⁶ The PERS calculations are included in the record as Exs. S9-S25. The methodology used by PERS is described in the Rodeman Declaration, Ex. S26, ¶¶ 27-42.

¹⁰⁷ PERS also calculated the effect using MacLennan's life expectancy assumption, but reducing MacLennan's numbers to net present value based on the assumed earnings rate of 7.75%.

A. Moro Petitioners

I. Everice Moro

Petitioner Moro (DOB 3/19/49) is a Tier I PERS retiree and an Oregon resident. (Ex. 1). Prior to retirement, she was employed as an Educational Assistant by the Estacada School District and was a member of the Oregon School Employees Association (OSEA). She retired from PERS employment effective July 1, 2011, under the Money Match calculation method, Benefit Option 2A, with a gross monthly benefit of \$1,509.28 and with 30 years and 3 months of service. Based on this service time, her SB 656 benefit percent is 4%. Of this service, 10 years and 7 months were prior to October 1, 1991, resulting in an HB 3349 benefit of 3.4602%. She has a COLA carryover of 1.67% as of July 1, 2013.

The projected reductions in Moro's benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$8,101	\$68,573
Reduction in total expected payments (PERS)	\$7,018	\$67,880
Present Value of Reduction (PERS)	\$2,284	\$20,717
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$2,043	\$18,813
% Reduction (MacLennan)	1.2%	10.2%
% Reduction (PERS, using present values)	0.83%	7.54%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	0.75%	6.88%

2. Terri Domenigoni

Petitioner Domenigoni (DOB 7/1/49) is a Tier I PERS retiree and an Oregon resident. Prior to retirement, she was employed as an Elementary School teacher by the Oregon City School District and was a member of the Oregon Education Association (OEA). She retired from PERS employment effective July 1, 2005, under the Formula plus Annuity calculation method, Option 2A, with a gross monthly benefit of \$1,930.86 and with 24 years 0 months of service. Based on this service time, her SB 656 benefit percent is 2%. Of this service, 10 years and 3 months were prior to October 1, 1991, resulting in an HB 3349 benefit of 4.2239%. She has a COLA carryover of 3.77% as of July 1, 2013.

The projected reductions in Domenigoni’s benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$28,797	\$101,315
Reduction in total expected payments (PERS)	\$26,537	\$99,422
Present Value of Reduction (PERS)	\$7,438	\$27,525
Present Value of Reduction (PERS, using MacLennan’s life expectancy estimate)	\$7,336	\$27,268
% Reduction (MacLennan)	3.0%	10.5%
% Reduction (PERS, using present values)	1.9%	7.07%
% Reduction (PERS, using present values and MacLennan’s life expectancy estimate)	1.89%	7.01%

3. Charles Custer

Petitioner Custer (DOB 6/27/40) is a Tier I PERS retiree and an Oregon resident. Prior to retirement, he was employed as a Fire Fighter by the Tualatin Valley Fire & Rescue and was a member of the International Association of Fire Fighters (IAFF). He retired from PERS employment effective July 1, 1993, under the Full Formula calculation method, Option 3A, with a gross monthly benefit of \$2,740.83 and with 25 years 0 months of service. Based on this service time, his SB 656 benefit percent is 3.0%. Of this service, 23 years and 3 months were prior to October 1, 1991, resulting in an HB 3349 benefit of 9.1978%. He has a COLA carryover of 13.31% as of July 1, 2013.

The projected reductions in Custer's benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$44,287	\$72,200
Reduction in total expected payments (PERS)	\$30,115	\$53,668
Present Value of Reduction (PERS)	\$14,339	\$24,785
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$16,114	\$28,669
% Reduction (MacLennan)	4.2%	6.9%
% Reduction (PERS, using present values)	2.59%	4.48%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	2.76%	4.91%

4. John Hawkins

Petitioner Hawkins (DOB 5/2/45) is a Tier I PERS retiree and an Oregon resident. Prior to retirement, he was employed by Linn County and was a member of the Service

Employees International Union (SEIU). He retired from PERS employment effective February 1, 2003, under the Money Match calculation method, Option 2, with a gross monthly benefit of \$2,289.09 and with 25 years 3 months of service. Based on this service time, his SB 656 benefit percent is 3.0%. Of this service, 13 years and 11 months were prior to October 1, 1991, resulting in an HB 3349 benefit of 5.4510%. He has a COLA carryover of 3.77% as of July 1, 2013.

The projected reductions in Hawkins’ benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$32,752	\$91,371
Reduction in total expected payments (PERS)	\$28,190	\$84,388
Present Value of Reduction (PERS)	\$9,447	\$27,825
Present Value of Reduction (PERS, using MacLennan’s life expectancy estimate)	\$9,567	\$28,164
% Reduction (MacLennan)	3.30%	9.20%
% Reduction (PERS, using present values)	2.15%	6.32%
% Reduction (PERS, using present values and MacLennan’s life expectancy estimate)	2.16%	6.37%

5. Michael Arken

Petitioner Arken (DOB 1/28/46) is a Tier I PERS retiree and an Oregon resident. Prior to retirement, he was employed by City of Portland and was a member of the Oregon AFSCME Council 75 (AFSCME). He retired from PERS employment effective March 1, 2002, under the Money Match calculation method, Option 2, with a gross monthly benefit of \$2,505.60 and with 21 years 10 months of service. Based on this service time, his SB 656 benefit percent is 2.0%. Of this service, 11 years and 5 months

were prior to October 1, 1991, resulting in an HB 3349 benefit of 5.1715%. He has a COLA Bank balance of 3.77% as of July 1, 2013.

The projected reductions in Arken’s benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$59,767	\$147,540
Reduction in total expected payments (PERS)	\$51,038	\$133,690
Present Value of Reduction (PERS)	\$13,688	\$36,194
Present Value of Reduction (PERS, using MacLennan’s life expectancy estimate)	\$14,115	\$37,194
% Reduction (MacLennan)	4.48%	11.06%
% Reduction (PERS, using present values)	2.69%	7.11%
% Reduction (PERS, using present values and MacLennan’s life expectancy estimate)	2.74%	7.23%

6. Eugene Ditter

Petitioner Ditter (DOB 7/31/53) is a Tier I PERS retiree and an Oregon resident. Prior to retirement, he was employed as an Apparatus Operator and Paramedic by the Tualatin Valley Fire & Rescue and was a member of the International Association of Fire Fighters (IAFF). He retired from PERS employment effective January 1, 2003, under the Full Formula calculation method, Option 3, with a gross monthly benefit of \$6,339.94 and with 30 years 0 months of service. Based on this service time, his SB 656 benefit percent is 4.0%. Of this service, 18 years and 9 months were prior to October 1, 1991, resulting in an HB 3349 benefit of 6.1813%. He has a COLA carryover of 3.77% as of July 1, 2013.

The projected reductions in Ditter’s benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$458,474	\$530,421
Reduction in total expected payments (PERS)	\$363,661	\$423,905
Present Value of Reduction (PERS)	\$108,479	\$126,717
Present Value of Reduction (PERS, using MacLennan’s life expectancy estimate)	\$113,713	\$132,943
% Reduction (MacLennan)	13.6%	11.06%
% Reduction (PERS, using present values)	8.20%	9.58%
% Reduction (PERS, using present values and MacLennan’s life expectancy estimate)	8.44%	9.87%

7. John O’Kief

Petitioner O’Kief (DOB 9/9/45) is a Tier I PERS retiree who is a resident of Sequim, Washington. Prior to retirement, he was employed as an Elementary School teacher by the Ontario School District and was a member of the Oregon Education Association (OEA). He retired from PERS employment effective June 1, 2002, under the Money Match calculation method, Option 2, with a gross monthly benefit of \$3,372.50 and with 27 years 11 months of service. Based on this service time, his SB 656 benefit percent is 3.0%. Of this service, 17 years and 3 months were prior to October 1, 1991, resulting in an HB 3349 benefit of 6.1112%. He has a COLA carryover of 3.77% as of July 1, 2013.

The projected reductions in O’Kief’s benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861	Effect of SB 822 (SB 656/HB 3349 benefits only)
Reduction in total expected payments (MacLennan)	\$239,628	\$351,732	\$65,320
Reduction in total expected payments (PERS)	\$214,803	\$314,176	\$61,892
Present Value of Reduction (PERS)	\$52,642	\$75,599	\$20,814
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$54,316	\$77,934	\$21,095
% Reduction (MacLennan)	10.7%	15.7%	2.83%
% Reduction (PERS, using present values)	7.15%	10.27%	2.83%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	7.28%	10.44%	2.83%

8. *Michael Smith*

Petitioner Smith (DOB 10/20/39) is a Tier I PERS retiree who is a resident of Tucson, Arizona. Prior to retirement, he was employed as a Principal by the Beaverton School District and is a member of the Oregon PERS Retirees, Inc. (OPRI). He retired from PERS employment effective July 1, 1996, under the Money Match calculation method, Option 1, with a gross monthly benefit of \$4,466.81 and with 30 years 0 months of service. He changed his option to 15-year certain on November 11, 1996. Based on his service time at retirement, his SB 656 benefit percent is 5.0%. Of this service, 25 years and 3 months were prior to October 1, 1991, resulting in an HB 3349 benefit of 8.3242%. He has a COLA carryover of 8.49% as of July 1, 2013.

The projected reductions in Smith's benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861	Effect of SB 822 (SB 656/HB 3349 benefits only)
Reduction in total expected payments (MacLennan)	\$91,350	\$104,206	\$41,907
Reduction in total expected payments (PERS)	\$87,743	\$99,683	\$41,317
Present Value of Reduction (PERS)	\$51,250	\$57,843	\$26,566
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$51,974	\$58,337	\$26,790
% Reduction (MacLennan)	8.4%	9.6%	3.69%
% Reduction (PERS, using present values)	7.12%	7.99%	3.69%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	7.16%	8.04%	3.69%

9. Lane Johnson

Petitioner Johnson (DOB 8/17/55) is an active Tier I PERS member and an Oregon resident. He is employed as a teacher by West Linn School District and is a member of the Oregon Education Association (OEA). As of May 31, 2013, he had 23 years and 3 months of credited service time. If he retired as intended effective July 1, 2014, he would have a total of 24 years and 4 months of service time and would retire under the Full Formula calculation method. Based on this service time, his SB 656 benefit percent would be 2.0%. Of this service time, 1 years and 7 months were before 1991, resulting in an HB 3349 benefit of 0.6435%.

The projected reductions in Johnson's benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$31,418	\$140,867
Reduction in total expected payments (PERS)	\$56,761	\$167,515
Present Value of Reduction (PERS)	\$13,528	\$37,123
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$13,709	\$37,647
% Reduction (MacLennan)	2.8%	12.4%
% Reduction (PERS, using present values)	3.66%	10.05%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	3.69%	10.13%

10. Greg Clouser

Petitioner Clouser (DOB 2/8/68) is an active Tier II PERS member and an Oregon resident. He is employed as a Corrections Corporal by the State of Oregon, Department of Corrections and is a member of Oregon AFSCME (AFSCME). As of May 31, 2013, he had 12 years and 3 months of credited service time. If he retired at age 55, he would have a total of 22 years and 1 months of service time and would retire under the Full Formula calculation method.

The projected reductions in Johnson's benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$157,492	\$294,914
Reduction in total expected payments (PERS)	\$158,286	\$295,000
Present Value of Reduction (PERS)	\$13,631	\$27,804
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$14,069	\$28,500
% Reduction (MacLennan)	7.4%	13.8%

% Reduction (PERS, using present values)	4.36%	8.89%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	4.46%	9.02%

11. Brandon Silence

Petitioner Silence (DOB 10/28/81) is an active OPSRP member and a resident of Oregon. He is employed as a Fire Fighter/Paramedic by City of Salem and is a member of the International Association of Fire Fighters (IAFF). As of December 31, 2013, he had 6 years and 5 months of credited service time. If he retired as intended effective July 1, 2035, he would have a total of 28 years and 11 months of service time and would retire under the OPSRP Formula calculation method. If he selected Option 2 and his beneficiary is his age, his projected monthly benefit amount at retirement would be \$7,922.

The projected reductions in Silence's benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$1,107,583	\$1,260,580
Reduction in total expected payments (PERS)	\$1,101,958	\$1,254,299
Present Value of Reduction (PERS)	\$37,915	\$43,698
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$38,764	\$44,646
% Reduction (MacLennan)	19.7%	22.59%
% Reduction (PERS, using present values)	12.27%	14.15%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	12.45%	14.34%

12. Alison Vickery

Petitioner Vickery (DOB 6/5/61) is an active Tier II PERS member and an Oregon resident. She is employed as a teacher by the Bend School District and is a member of the Oregon Education Association (OEA). As of May 31, 2013, she had 12 years and 2 months of credited service time. If she retired as intended at age 60 effective July 1, 2021, she would have a total of 20 years and 3 months of service time and would retire under the Full Formula calculation method. If she selected Option 2 and her beneficiary is her age, her projected monthly benefit amount at retirement would be \$2,167.

The projected reductions in Vickery’s benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$38,389	\$147,862
Reduction in total expected payments (PERS)	\$38,054	\$151,875
Present Value of Reduction (PERS)	\$4,287	\$18,907
Present Value of Reduction (PERS, using MacLennan’s life expectancy estimate)	\$4,498	\$19,591
% Reduction (MacLennan)	3.2%	12.2%
% Reduction (PERS, using present values)	1.92%	8.47%
% Reduction (PERS, using present values and MacLennan’s life expectancy estimate)	1.99%	8.66%

13. Jin Voeks

Petitioner Voeks (DOB 5/20/83) is an active OPSRP member and an Oregon resident. He is employed as a Fire Fighter by the City of Portland and is a member of the International Association of Fire Fighters (IAFF). As of December 31, 2012, he had 2

years and 0 months of credited service time. If he retired as intended at age 53, he would have a total of 25 years and 6 months of service time and would retire under the OPSRP Formula calculation method. If he selected Option 2 and his beneficiary is his age, his projected monthly benefit amount at retirement would be \$4,334.

The projected reductions in Voeks' benefits attributable to SB 822 and SB 861 are shown in the following chart:

Projected Effect	Effect of SB 822 only	Effect of SB 822 and SB 861
Reduction in total expected payments (MacLennan)	\$366,416	\$497,419
Reduction in total expected payments (PERS)	\$326,823	\$456,364
Present Value of Reduction (PERS)	\$9,657	\$14,344
Present Value of Reduction (PERS, using MacLennan's life expectancy estimate)	\$9,800	\$14,527
% Reduction (MacLennan)	11.8%	16.0%
% Reduction (PERS, using present values)	6.36%	9.45%
% Reduction (PERS, using present values and MacLennan's life expectancy estimate)	6.55%	9.72%

B. Self-Represented Petitioners

1. Wayne Stanley Jones¹⁰⁸

Petitioner Jones receives a PERS retirement based on his continuous employment at the Portland Development Commission (PDC) from July 1, 1967, through February 28, 1998. At the time of Jones' retirement, effective March 1, 1998, he was credited with 30 years and 8 months of service with the PDC. Twenty-four years and 3 months of Jones'

¹⁰⁸ Facts relating to petitioner Jones are found in his affidavit (Ex. 63); the Joint Stipulated Facts, pp. 35-38, ¶¶ 1-11; and Exs. S22 and S25.

service occurred prior to October 1, 1991. Jones is a “Tier 1” member of PERS, having joined the system prior to January 1, 1996.

When Jones retired, on the Service Retirement Application, he chose retirement benefit Option 2 Annuity, Full Survivorship, which provided full benefits to his spouse, Christine O. Jones, if Jones predeceased her. Jones received a Notice of Entitlement from PERS, dated April 10, 1998, which confirmed his retirement benefit with PERS by specifying his monthly retirement benefit under Option 2 Annuity.

Jones was born in Oregon in 1943 and resided continuously in Oregon until 2006, when personal family circumstances necessitated a move to another state. He now lives at 18 North Foxhill Road, North Salt Lake, Utah 84054.

Effective August 1, 2013, PERS increased Jones' service retirement allowance by 1.5% as a result of Section 1 of Oregon Senate Bill 822, signed into law by Governor Kitzhaber on May 6, 2013. By letter dated December 18, 2013, PERS informed Jones that his service retirement allowance would be reduced as a result of legislation passed in 2013. The letter advised Jones, among other things, that:

“You currently receive an increase in your monthly PERS benefit as a statutory remedy for Oregon state income tax (“tax remedy”).

“Legislation passed in 2013 eliminated this tax remedy for benefit recipients who do not pay Oregon state income tax on their PERS benefits because they do not reside in Oregon. Recently, PERS received notification that you did not pay income taxes in Oregon because you are not an Oregon resident.

“Therefore, your monthly PERS benefit is being adjusted to remove the tax remedy. Your gross monthly benefit will be reduced by \$520.01. Your adjusted monthly gross benefit will be \$6,649.20, effective with the payment you receive on January 1, 2014.”

PERS has estimated the yearly allowance differences, both year by year and cumulatively, for Jones, depending on the outcome of the pending litigation. If SB 822 and SB 861 are declared invalid in their entirety with respect to reductions in the service retirement allowance due to petitioner's non-residency and COLA, and assuming a COLA percentage each year of 2%, Jones is projected to receive over his current joint life expectancy of 21.3 years benefits totaling \$2,272,760.45. Discounted to present value, that total is \$1,117,063.

If SB 822 is declared valid and SB 861 is declared invalid, Jones is projected to receive \$1,911,594 over his current joint life expectancy of 21.3 years. Discounted to present value, that total is \$962,984. If SB 822 and SB 861 are declared valid in their entirety, Jones is projected to receive benefits totaling \$1,873,937 over his current joint life expectancy of 21.3 years. Discounted to present value, that total is \$948,416.

Based on PERS' calculations, SB 822 alone will reduce Jones' total expected benefits of \$271.447 without discounting to present value. The present value of that reduction is \$110,244, or 9.87% of the present value of his total expected benefits payments. SB 822 and SB 861 together will reduce his total expected benefits by \$307,562 without discounting to present value. The present value of that reduction is \$123,530, or 11.06% of the present value of his total expected benefits payments. If SB 822's elimination of SB 656/HB3349 benefits is upheld but the COLA changes in SB 822 and SB 861 are struck down, Jones' projected benefits would be reduced by \$84,316 without discounting to present value. The present value of that reduction would be \$41,442, or 3.71% of the present value of his total expected benefits payments.

2. Michael D. Reynolds¹⁰⁹

Petitioner Reynolds became a member of PERS on Dec 1, 1976. He is thus a “Tier 1” member of PERS, having joined the system prior to January 1, 1996. At all times until his retirement on March 1, 2003, he performed work for the State of Oregon, the majority of that time with the Department of Justice. At the time of his retirement, he had been an active member of PERS for 26 years and 9 months. Reynolds' active service as a member of PERS before October 1, 1991, was 15 years and 4 months.

Reynolds submitted his service retirement application with PERS on January 9, 2003. His application listed his address as “7425 Latona Ave. N. Seattle, WA 98115.” On February 10, 2003, PERS mailed to Reynolds at his Seattle address an Estimate of Service Retirement Benefits. The estimate stated that his estimated benefits included “a 5.6691% benefit increase (BEN INCR) per OREGON REVISED STATUTES 238.380.” On May 22, 2003, PERS mailed to Reynolds at his Seattle address a “Notice of Entitlement – Adjusted for Divorce Award.” That Notice of Entitlement listed Reynolds' gross amount under Option 3, the option he had chosen, as \$4,136.33. That amount was \$20.61 higher than the earlier estimate.

On July 25, 2003, PERS mailed a notice to Reynolds at his Seattle address that his cost-of-living allowance (COLA) “has been suspended temporarily as a result of House Bill 2003.” The notice stated, *inter alia*:

¹⁰⁹ Facts relating to petitioner Reynolds are found in his declaration (Ex. 61); the Joint Stipulated Facts, pp. 38-43, ¶¶ 1-12; and Exs. S23 and S25.

“The COLA change is due to 1999 account crediting rates. Tier One accounts were credited at 20 percent. The legislation determined that accounts should have been credited at 11.33 percent. Once the two amounts reconcile, COLA payments will begin again. PERS will perform a yearly calculation on your account to ensure COLA payments restart on time. We will notify you when you COLA payments are set to resume, and no action is required on your part.”

On May 4, 2006, PERS received from Reynolds a completed change-of-address form, in which he listed his new address as: “8012 Sunnyside Ave N., Seattle, WA 98103.” Reynolds checked the box stating “I am **not** an Oregon resident.” On March 6, 2008, PERS by letter informed Reynolds that it had recalculated his benefit as a result of the *Strunk* and *City of Eugene* litigation and the PERS Board's Settlement Agreement in the *Eugene* case. Subtracting what was actually paid to Reynolds during the period his COLA was frozen and what should have been paid to Reynolds, and factoring in the results of the *Strunk* and *City of Eugene* litigation left an overpayment amount of \$6,061.72. The letter informed Reynolds that at that time a lawsuit was pending concerning PERS' authority to collect the overpayment, and that no action would be taken to collect the overpayment until PERS had received more direction from the courts.

On January 25, 2013, PERB by letter informed Reynolds that he had been overpaid the amount of \$6061.72 and explained his repayment options. Reynolds chose the “default” option, consisting of a repayment deduction from his monthly service retirement allowance of 2%. Effective August 1, 2013, PERS increased Reynolds' service retirement allowance by 1.5% in accordance with section 1 of Senate Bill 822.

On December 18, 2013, PERS by letter informed Reynolds that his service retirement allowance would be reduced as a result of the legislature's enactment of Senate Bill 822. The letter advised Reynolds, *inter alia*, as follows:

“You currently receive an increase in your monthly PERS benefit as a statutory remedy for Oregon state income tax ("tax remedy"). Legislation passed in 2013 eliminated this tax remedy for benefit recipients who do not pay Oregon state income tax on their PERS benefits because they do not reside in Oregon. Recently, PERS received notification that you did not pay income taxes in Oregon because you are not an Oregon Resident.' Therefore, your monthly PERS benefit is being adjusted to remove the tax remedy. Your gross monthly benefit will be reduced by \$254.06. Your adjusted monthly gross benefit will be \$4,481.44, effective with the payment you receive on January 1, 2014.”

PERS has estimated the yearly allowance differences, both year by year and cumulatively, for Reynolds, depending on the outcome of the pending litigation. If Senate Bills 822 and 861 are declared invalid in their entirety with respect to reductions in the service retirement allowance due to Reynolds' non-residency and COLA, and assuming a COLA percentage each year of 2%, then Reynolds is projected to receive benefits totaling \$1,475,776 over his current joint life expectancy of 23 years (2013 – 2035) without discounting to present value. Discounted to present value, that total is \$729,803.

If Senate Bill 822 is declared valid except to the extent that it takes away benefits authorized by Senate Bill 656, and if Senate Bill 861 also is declared valid, Reynolds is projected to receive benefits totaling \$1,321,597 over his current joint life expectancy of 23 years, without discounting to present value. That amounts to an overall reduction in Reynolds' service retirement allowance of \$154,179, or an average of \$6,703 per year,

without discounting to present value. This represents a reduction in Reynolds' allowance of 10.45%.

If Senate Bills 822 and 861 are declared valid in their entirety, Reynolds is projected to receive benefits totaling \$1,283,129 over his current joint life expectancy of 23 years, without discounting to present value. That amounts to an overall reduction in his service retirement allowance of \$192,647, or an average of \$8,376 per year, without discounting to present value. This represents a reduction in his allowance of 13.05%.

Based on PERS' calculations, SB 822 alone will reduce Reynolds' total expected benefits by \$117,428 without discounting to present value. The present value of that reduction is \$48,579, or 6.66% of the present value of his total expected benefits payments. SB 822 and SB 861 together will reduce his total expected benefits by \$151,269 without discounting to present value. The present value of that reduction is \$60,989, or 8.36% of the present value of his total expected benefits payments. If SB 822's elimination of SB 656/HB3349 benefits is upheld but the COLA changes in SB 822 and SB 861 are struck down, Reynolds' projected benefits would be reduced by \$61,197 without discounting to present value. The present value of that reduction would be \$21,719, or 2.84% of the present value of his total expected benefits payments.

3. *George A. Riemer*¹¹⁰

Petitioner Riemer is a “Tier 1” member of PERS. He retired on April 1, 2006, and was credited with 284 months of public service based on his employment with the Oregon State Bar. His PERS Notice of Entitlement was dated June 15, 2006. Riemer's active service as a member of PERS before October 1, 1991, was 110 months out of a total of 284 months of such service.

Effective August 1, 2013, PERS increased Riemer's service retirement allowance by 1.5% in accordance with section 1 of Senate Bill 822. By letter dated December 18, 2013, PERS informed Riemer that his service retirement allowance would be reduced as a result of the enactment into law of SB 822. The letter advised petitioner Riemer, *inter alia*, as follows:

“You currently receive an increase in your monthly PERS benefit as a statutory remedy for Oregon state income tax (“tax remedy”). Legislation passed in 2013 eliminated this tax remedy for benefit recipients who do not pay Oregon state income tax on their PERS benefits because they do not reside in Oregon. Recently, PERS received notification that you did not pay income taxes in Oregon because you are not an Oregon Resident. Therefore, your monthly PERS benefit is being adjusted to remove the tax remedy. Your gross monthly benefit will be reduced by \$256.32. Your adjusted monthly gross benefit will be \$6,691.12, effective with the payment you receive on January 1, 2014.”

Riemer is currently a full-time resident of Arizona. He may reestablish full-time or part-time residence (domicile) in Oregon at any time in the future.

¹¹⁰ Facts relating to petitioner Riemer are found in his declaration (Ex. 62); the Joint Stipulation of Facts, pp. 43-45, ¶¶ 2-8; and Exs. S24 and S25.

PERS predicates the granting, elimination, and reestablishment of what the state refers to as a “tax remedy” benefit increase on a retiree’s residence (domicile) in Oregon regardless of whether, on application of the applicable state income tax laws, the retiree is obligated to pay any Oregon state income tax or none at all. SB 822 and the administrative rules PERS has adopted to implement SB 822 require a non-resident retiree who reestablishes residence (domicile) in Oregon on January 2 of any year to wait until January 1 of the following year to be entitled to the reestablishment of the retiree’s “tax remedy” benefit increase.

PERS has estimated the yearly service retirement allowance differences, both year by year and cumulatively, for Riemer, depending on the outcome of the pending litigation. If SB 822 and SB 861 are declared invalid in their entirety, and assuming a COLA percentage each year of 2%, Riemer and his wife are projected to receive over their current combined life expectancy of 28.4 years, \$3,177,080 without discounting to present value.

If SB 822 is declared invalid only as to the elimination of SB 656/HB 3349 benefits and with the reduced COLA codified in Senate Bill 861 left in place, Riemer and his wife are projected to receive over their combined life expectancy of 28.4 years, \$2,651,260 without discounting to present value, a loss totaling \$525,820 without discounting to present value.

If SB 822 and SB 861 are determined to be valid in every respect, Riemer and his wife are projected to receive over their combined life expectancy of 28.4 years, \$2,599,299, a loss totaling \$577,788 without discounting to present value.

Based on PERS' calculations, SB 822 alone will reduce Riemer's total expected benefits by \$443,165 without discounting to present value. The present value of that reduction is \$125,826, or 10.14% of the present value of his total expected benefits payments. SB 822 and SB 861 together will reduce his total expected benefits by \$511,873 without discounting to present value. The present value of that reduction is \$144,557, or 11.65% of the present value of his total expected benefits payments. If SB 822's elimination of SB 656/HB3349 benefits is upheld but the COLA changes in SB 822 and SB 861 are struck down, Riemer's projected benefits would be reduced by \$61,197 without discounting to present value. The present value of that reduction would be \$23,903, or 1.93% of the present value of his total expected benefits payments.

IX. RESPONDENT-SPECIFIC INFORMATION

A. School District Respondents

In the 2005-07, 2007-09, and 2009-11 state budget cycles, the net employer contribution rates paid by the School District respondents generally remained in the single digits.¹¹¹

A school district that has a "side account" with PERS may use the money deposited into the side account to pay a portion of the school district's base employer contribution rate. Side accounts are typically funded through the sale of pension bonds as

¹¹¹ Joint Stipulated Facts, p. 48, ¶ 42

described above. A school district incurs annual costs to pay the debt service on any pension bonds it sells to fund its side account.¹¹²

The Estacada School District spends \$850,490 annually to pay the debt service on the pension bonds it sold to fund its side account.¹¹³ The Bend-LaPine School District spends \$5,469,485 annually to pay the debt service on the pension bonds it sold to fund its side account.¹¹⁴ The Ontario School District expended \$714,073 in 2013-14 to pay the debt service on the pension bonds it sold to fund its side account.¹¹⁵ The Oregon City School District spends \$3,381,625 annually to pay the debt service on the pension bonds it sold to fund its side account.

In the 2011-2013 biennium, Estacada School District's net employer contribution rates increased from 3.56% to 11.71% for PERS Tier I/Tier II, and from 4.08% to 10.20% for OPSRP.¹¹⁶ The Bend-LaPine School District's net employer contribution rates for the 2011-2013 biennium increased from 1.94% to 11.28% for PERS Tier I/Tier II, and from 2.46% to 9.77% for OPSRP.¹¹⁷ The Ontario School District's net employer contribution rates for the 2011-2013 biennium increased from 6.19% to 13.39% for PERS

¹¹² Joint Stipulated Facts, p. 48, ¶ 43.

¹¹³ Ex. SDLC 103, ¶ 6.

¹¹⁴ Ex. SDLC 104, ¶ 7.

¹¹⁵ Ex. SDLC 105, ¶ 7.

¹¹⁶ Ex. SDLC 103, ¶ 5.

¹¹⁷ Ex. SDLC 104, ¶ 5.

Tier I/Tier II, and from 6.71% to 11.88% for OPSRP.¹¹⁸ The Oregon City School District’s net employer contribution rates for the 2011-2013 biennium increased from 3.00% to 10.75% for PERS Tier I/Tier II, and from 3.52% to 9.24% for OPSRP.¹¹⁹

In the Bend–La Pine School District, the net employer contribution rates increased from approximately 2% of payroll in the 2009 biennium, to 10-11% in the 2011 biennium, to 16-18% in the 2013 biennium. In the Ontario School District, net employer contribution rates increased from approximately 6% in the 2009 biennium, to 12-13% in the 2011 biennium, to 18-20% in the 2013 biennium. In the Oregon City School District, net employer contribution rates increased from approximately 4-5% in the 2009 biennium, to 9-11% in the 2011 biennium, to 15-17% in the 2013 biennium. In the Estacada School District, net employer contribution rates increased from approximately 4% in the 2009 biennium, to 10-12% in the 2011 biennium, to 16-18% in the 2013 biennium.¹²⁰

In the Bend–La Pine School District, the district employs approximately 30 fewer full-time-equivalent (“FTE”) teaching positions in 2013-2014 than it did five years ago. Student enrollment in the district has increased by more than 750 students during this period. As a result, the district has 60 fewer teachers than it would need to maintain the same student-to-teacher ratio it had five years ago. The Ontario School District reduced

¹¹⁸ Ex. SDLC 105, ¶ 5.

¹¹⁹ Ex. SDLC 106, ¶ 4.

¹²⁰ Joint Stipulated Facts, p. 49, ¶ 45.

its teaching staff from 180 in 2008-2009 to 135 in 2012-2013. This 25% reduction in teaching staff exceeded the 10% reduction in student enrollment experienced by the district during this time period.¹²¹

PERS recalculated the net employer contribution rates for the 2013-2015 biennium after the enactment of SB 822 and SB 861. The recalculated rates for the Estacada, Bend-LaPine, Ontario, and Oregon City school districts were 4.4% lower than PERS had originally calculated before SB 822 and SB 861 were enacted.¹²²

As a result of the recalculated net employer contribution rates, the Estacada School District saved \$421,212 and the Ontario School District saved \$465,690 in their budgets for the 2013-15 biennium. Those savings are equivalent to the cost of 5-6 teachers. The Oregon City School District saved \$1.7 million in its 2013-15 budget, equivalent to the cost of 19 teachers, 35 classified employees, or nine additional instructional days. The Bend-LaPine School District saved approximately \$3.4 million in its 2013-15 budget, equivalent to the cost of about 47 teachers or seven additional instructional days. The Bend-La Pine School District returned to a full school year in 2013-14 and added teaching positions to reduce class sizes in kindergarten, first grade, and at the high school level.¹²³

Respondent West-Linn Wilsonville School District's funding for the period 2005-

¹²¹ Joint Stipulated Facts, pp. 49-50, ¶ 46.

¹²² Joint Stipulated Facts, p. 50, ¶ 47.

¹²³ Joint Stipulated Facts, p. 50, ¶ 48.

2015¹²⁴ was estimated as follows:

School Year	ADMW¹²⁵	Total Formula Revenue per Extended ADMW	Total Formula Revenue
2005-2006	8,950.50	\$5,540	\$49,586,331
2006-2007	9,170.90	\$5,900	\$54,108,893
2007-2008	9,170.90	\$6,223	\$57,073,874
2008-2009	9,187.30	\$6,096	\$56,007,737
2009-2010	9,185.40	\$6,147	\$56,462,396
2010-2011	9,264.31	\$6,014	\$55,719,470
2011-2012	9,274.22	\$6,199	\$57,487,021
2012-2013	9,427.35	\$6,318	\$59,561,862
2013-2014	9,776.06	\$6,825	\$66,721,161
2014-2015	9,933.10	\$7,181	\$71,332,201

Respondent Oregon City School District’s funding for the period 2005-2015 was estimated as follows:

School Year	ADMW	Total Formula Revenue per Extended ADMW	Total Formula Revenue
2005-2006	9,271.80	\$5,506	\$51,051,802
2006-2007	9,143.60	\$5,864	\$53,620,109
2007-2008	9,393.10	\$6,188	\$58,125,259
2008-2009	9,376.00	\$6,052	\$56,742,470
2009-2010	9,357.50	\$6,136	\$57,413,348
2010-2011	9,279.96	\$6,013	\$55,796,804
2011-2012	9,332.00	\$6,191	\$57,772,836
2012-2013	9,345.00	\$6,320	\$59,059,079
2013-2014	9,250.78	\$6,842	\$63,291,797
2014-2015	9,194.91	\$7,197	\$66,084,607

¹²⁴ The School District funding information, as reported by the Oregon Department of Education, is in the record at Exs. 64-69 and is included in the Joint Stipulated Facts at pp. 30-33, ¶¶ 109-114.

¹²⁵ ADMW refers to a weighted average daily membership of a school district. See ORS 327.006(3) (defining “average daily membership” or “ADM”); ORS 327.013(1)(c) (defining “weighted average daily membership” or “ADMw”).

Respondent Estacada School District's funding for the period 2005-2015 was estimated as follows:

School Year	ADMW	Total Formula Revenue per Extended ADMW	Total Formula Revenue
2005-2006	2,886.70	\$5,548	\$16,014,987
2006-2007	2,779.20	\$5,903	\$16,405,166
2007-2008	2,732.20	\$6,189	\$16,910,496
2008-2009	2,972.00	\$6,024	\$17,902,732
2009-2010	3,262.20	\$6,076	\$19,821,679
2010-2011	3,262.24	\$5,917	\$19,303,395
2011-2012	3,316.80	\$6,152	\$20,403,621
2012-2013	3,278.20	\$6,163	\$20,202,090
2013-2014	3,138.25	\$6,705	\$21,042,967
2014-2015	2,744.64	\$7,133	\$19,576,703

Respondent Bend-La Pine School District's funding for the period 2005-2015 was estimated as follows:

School Year	ADMW	Total Formula Revenue per Extended ADMW	Total Formula Revenue
2005-2006	16,802.90	\$5,485	\$92,160,949
2006-2007	17,170.70	\$5,826	\$100,042,204
2007-2008	17,761.40	\$6,141	\$109,078,492
2008-2009	17,885.10	\$6,022	\$107,520,720
2009-2010	17,855.10	\$6,120	\$109,274,439
2010-2011	18,115.44	\$5,981	\$108,354,855
2011-2012	18,160.03	\$6,180	\$112,236,904
2012-2013	18,421.67	\$6,299	\$116,032,143
2013-2014	18,471.81	\$6,814	\$125,865,191
2014-2015	18,879.43	\$7,152	\$135,028,138

Respondent Ontario School District's funding for the period 2005-2015 was estimated as follows:

School Year	ADMW	Total Formula Revenue per Extended ADMW	Total Formula Revenue
2005-2006	3,590.50	\$5,446	\$19,552,935
2006-2007	3,590.50	\$5,780	\$20,753,043
2007-2008	3,537.30	\$6,108	\$21,604,999
2008-2009	3,411.40	\$5,972	\$20,373,122
2009-2010	3,333.70	\$6,034	\$20,116,202
2010-2011	3,308.97	\$5,902	\$19,528,727
2011-2012	3,308.97	\$6,113	\$20,228,007
2012-2013	3,216.82	\$6,234	\$20,055,211
2013-2014	3,202.68	\$6,753	\$21,626,242
2014-2015	3,198.21	\$7,075	\$22,627,248

Respondent Beaverton School District's funding for the period 2005-2015 was estimated as follows:

School Year	ADMW	Total Formula Revenue per Extended ADMW	Total Formula Revenue
2005-2006	42,425.30	\$5,414	\$229,707,068
2006-2007	43,361.30	\$5,768	\$250,128,666
2007-2008	43,408.20	\$6,084	\$264,093,694
2008-2009	43,471.30	\$5,976	\$259,767,156
2009-2010	43,933.40	\$6,053	\$265,950,432
2010-2011	44,647.62	\$5,915	\$264,079,704
2011-2012	44,956.91	\$6,122	\$275,217,042
2012-2013	45,131.46	\$6,242	\$281,691,636
2013-2014	45,421.95	\$6,761	\$307,089,053
2014-2015	45,828.81	\$7,158	\$328,024,479

B. Linn County

Linn County's net employer contribution rates for the 2009-2011 biennium were 12.00% of payroll for PERS Tier I/Tier II; 10.26% for OPSRP General Services; and 13.07% for OPSRP Police & Fire. Those rates increased for the 2011-2013 biennium to

16.06% for PERS Tier I/Tier II; 12.04% for OPSRP General Services; and 15.11 % for OPSRP Police & Fire. As originally set for the 2013 biennium, those rates would have increased to 18.06% for PERS Tier I/Tier II; 16.23% for OPSRP General Services; and 18.96% for OPSRP Police & Fire.¹²⁶

Federal forest payments to Linn County have been reduced by more than \$8 million since fiscal year 2007-08. Reductions in the County's local option law enforcement levy resulted in a loss of nearly \$5 million in fiscal year 2013-14. Those revenue losses have resulted in cutbacks in essential services, such as the closure of a 48-bed pod in the county jail in 2012.¹²⁷

PERS recalculated Linn County's net employer contribution rates for the 2013-2015 biennium after the enactment of SB 822 and SB 861. As a result, Linn County's net employer contribution rates for the 2013-2015 biennium were changed to 15.56% of payroll for PERS Tier I/Tier II; 13.73% for OPSRP General Services; and 16.46% for OPSRP Police & Fire. This represented a reduction of 2.47% of payroll, resulting in savings of approximately \$835,682 in Linn County's budget for fiscal year 2013-2014. That savings is equivalent to the cost of 8.5 "average" positions (based on the average cost to the County of an employee) or about 7.5 deputy sheriff positions.¹²⁸

¹²⁶ Ex. SDLC 107, ¶¶ 4, 5.

¹²⁷ Joint Stipulated Facts, p. 51, ¶ 51.

¹²⁸ Joint Stipulated Facts, p. 52, ¶ 52.

C. Tualatin Valley Fire & Rescue¹²⁹

Tualatin Valley Fire and Rescue (“TVF&R”) was organized in 1989 by the merger, consolidation or contracting for services of many other fire districts. TVF&R employed two petitioners, Charles Custer and Eugene Ditter.

West Slope Fire Department (“West Slope”) first hired Custer in 1968. West Slope hired him under a contract that provided non-PERS retirement benefits that first granted benefits upon his future retirement, under the contract terms and conditions then in force. West Slope became part of Washington County Fire District No. 1 (“Dist. No. 1”) in 1972, which in turn, became part of TVF&R in 1989.

Custer first became eligible for PERS benefits July 1, 1981, while at District No. 1, though he previously worked for about 13 years under a predecessor retirement plan and agreement.

Tualatin Rural Fire Protection District (“Tualatin Rural”) first hired Ditter in 1973. Tualatin Rural hired him under a contract that provided for non-PERS retirement benefits, upon his future retirement, under the terms and conditions of the contract and retirement plan then in force. Tualatin Rural became a part of TVF&R in 1989.

Ditter first became eligible for PERS retirement benefits in 1989 when Tualatin Rural joined TVF&R, though he previously worked for about 17 years under the terms of a predecessor plan and contract.

¹²⁹ The TVF&R facts are stated in TVF&R’s “Proposed Stipulated Facts Regarding Petitioners Custer and Ditter” and the Declaration of Debra Guzman (Ex. TVFR 1). The Moro Petitioners did not controvert those facts. *See* Moro Petitioners’ “Response to TVF&R’s Proposed Stipulated Facts.”

At all times that they were employed by TVF&R or its predecessor entities, Custer and Ditter were subject to the terms of express contracts that governed their eligibility for retirement benefits.

D. City of Portland¹³⁰

According to the Chief Administrative Officer for City of Portland, the City's 2013-2014 budget includes annual budgeted expenditures totaling \$2.65 billion for delivering a variety of municipal services, including Police, Fire, Parks, Utility, and Transportation services.

With that budget, the City is not able to maintain the level of municipal services that it maintained before the recent economic recession. The City attributes this to the financial challenges of the economic recession and other non-economic budget challenges. Though the City's population has grown by more than 23,000 residents, discretionary revenue growth has failed to allow the City to maintain service levels. For the FY 2013-14 budget, the City cut over \$20 million from its ongoing service levels in order to balance the budget, resulting in more than 150 positions being eliminated.

In 2011, the net employer contribution rates to be paid by the City for the 2013-2015 biennium were originally set at 13.74% of payroll for Tier 1/2 employees, 11.92% of payroll for General Service OPSRP employees, and 14.65% of payroll for Public

¹³⁰ The City of Portland's facts were set forth in the Declaration of Fred Miller (Ex. P1). The Moro Petitioners did not controvert those facts. *See* Moro Petitioners' Response to City of Portland's Proposed Stipulated Facts."

Safety OPSRP employees. These rates reflected an increase of about 50% from the previous biennium.

Over the last four state budget cycles, the net employer contribution rates paid by the City were as follows:

Biennium	Tier I/II	OPSRP General Services	OPSRP Public Safety
2005-2007	8.07%	4.66%	8.27%
2007-2009	6.66%	9.21%	12.48%
2009-2011	4.30%	5.04%	7.75%
2011-2013	9.30%	7.69%	10.40%

As a result of SB 822 and SB 861, the City’s employer contribution rates for the 2013-2015 biennium were reduced to 9.34% of payroll for Tier 1 and Tier 2 employees, 7.52% of payroll for General Service OPSRP employees, and 10.25% of payroll for Public Safety OPSRP employees.

The difference between the net employer contribution rate that the City was scheduled to pay before the 2013 legislation and the rate it now pays as a result of that legislation is 4.4% for both Tier1/2 employees and for OPSRP employees. That 4.4% difference in the City’s net employer contribution rate currently represents more than \$12 million in the City’s budget, including over \$4.5 million in the General Fund.

X. CONCLUSION

This concludes the Special Master's report to the Oregon Supreme Court.

Dated this _____ day of April, 2014.

Stephen K. Bushong
Multnomah County Circuit Court Judge
Special Master to the Oregon Supreme Court