

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS

December 7, 2005

1:30 p.m.

MEMBERS PRESENT

Representative Bruce Weyhrauch, Chair
Representative Norman Rokeberg (via teleconference)
Representative Ralph Samuels (via teleconference)
Representative Paul Seaton
Representative Peggy Wilson (via teleconference)
Representative Max Gruenberg

MEMBERS ABSENT

Representative Carl Moses

OTHER LEGISLATORS PRESENT

Representative Kurt Olson
Representative Mike Chenault
Senator Tom Wagoner

COMMITTEE CALENDAR

DISCUSSION OF THE PERS/TRS FUNDING SHORTFALL

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

JUDY SALO

Kenai, Alaska

POSITION STATEMENT: Urged the committee to work toward a viable and sustainable solution.

CATHY CARROW

Soldotna, Alaska

POSITION STATEMENT: Urged the committee to work toward a viable and sustainable solution.

TRENA RICHARDSON

Soldotna, Alaska

POSITION STATEMENT: Expressed concern regarding the current PERS/TRS shortfall.

JOHN CZARNEZKI
Soldotna, Alaska

POSITION STATEMENT: Expressed concern regarding the current PERS/TRS shortfall.

DAVID TEAL, Director
Legislative Finance Division
Juneau, Alaska

POSITION STATEMENT: Provided expert testimony on the PERS/TRS shortfall.

MELANIE MILLHORN, Director
Health Benefits Section
Division of Retirement and Benefits
Department of Administration
Juneau, Alaska

POSITION STATEMENT: Provided expert testimony on the PERS/TRS shortfall.

GAIL SCHUBERT, Chair
Alaska Retirement Management Board

POSITION STATEMENT: Described the newly appointed ARM Board and its mission.

LARRY SEMMENS, Finance Director
City of Kenai
Kenai, Alaska

POSITION STATEMENT: Provided statistics from the City of Kenai and offered suggestions.

WALTON SMITH
St. Marys, Alaska

POSITION STATEMENT: Urged the state to provide information to communities on the consequences of withdrawal from PERS.

RICHARD CAMPBELL, Director
General Services
Kenai Peninsula Borough
Soldotna, AK

POSITION STATEMENT: Testified on behalf of the Mayor of Kenai.

JEROME SELBY, Mayor
Kodiak Island Borough

Kodiak, Alaska

POSITION STATEMENT: Urged the state to allow local management of PERS debt.

JEFFREY SINZ, Director of Finance

Municipality of Anchorage

Anchorage, Alaska

POSITION STATEMENT: Expressed concern regarding current PERS/TRS shortfall.

RICK GIFFORD, Manager

Kodiak Island Borough

Kodiak Alaska

POSITION STATEMENT: Expressed concern regarding the current PERS/TRS shortfall.

MELODY DOUGLAS, Chief Financial Officer

Kenai Peninsula Borough Schools

Soldotna, Alaska

POSITION STATEMENT: Expressed concern regarding the current PERS/TRS shortfall.

JERRY PATTERSON

POSITION STATEMENT: Expressed concern regarding the current PERS/TRS shortfall.

SAM TRIVETTE, President,

Retired Public Employees of Alaska

POSITION STATEMENT: Suggested that the ARM Board be given spending authority.

JAY DULANY Executive Vice President

Retired Employees of Alaska

Eagle River, Alaska

POSITION STATEMENT: Suggested that the ARM Board be given spending authority.

ACTION NARRATIVE

CHAIR BRUCE WEYHRAUCH called the House Special Committee on Ways and Means meeting to order at 1:30 p.m. Representatives Weyhrauch and Seaton were present at the call to order. Representatives Rokeberg, Samuels, and Wilson were present via teleconference. Also in attendance were Representatives Olson and Chenault and Senator Wagoner.

DISCUSSION OF THE PERS/TRS FUNDING SHORTFALL

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CHAIR WEYHRAUCH announced that the only order of business would be the discussion of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) funding shortfall. He further announced plans to have a report prepared regarding the findings of the committee as well as suggested recommendations. Chair Weyhrauch expressed his hope to have, in early January 2006, a proposal regarding the legislature's options for the unfunded liability. The purpose of the meeting was to obtain the views of those in the Kenai region regarding the unfunded liability. He specified the desire to look for solutions to implement and to review the implications of such to the state and municipalities.

CHAIR WEYHRAUCH noted one of the concerns with the unfunded liability is in regard to the impact it has on the operation of the communities. Therefore, he wanted to take testimony from municipal representatives regarding what they are doing and what they recommend doing about the unfunded liability. He expressed interest in how the state and local level could partner to address the issue. Chair Weyhrauch opined, "We want a secure future for our children and our residents, our businesses, and our policymakers in the future. I think a \$5.7 billion unfunded liability poses some significant risks to a stable state government and sources of financing for other kinds of projects if it is not dealt with."

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JUDY SALO, former legislator, teacher, and president of the National Education Association - Alaska, provided the following testimony:

I'm sure, as you stated earlier, that you don't want to rehash the arguments for and against the passage of SB 141. And with that in mind, I'll try to keep those issues separate. But I must say first, however that the passage of SB 141 did little to address the real problems faced by the state, by employers, and certainly by employees in the State of Alaska. To the contrary, it potentially causes new financial issues, as the

system will not be sustained with the contributions of new members after the effective date of July '06. So, I come before you today to ask [you] to consider specific legislation before that effective date."

MS. SALO referred to the \$5.7 billion dollar amount that had been put forth. She argued statistics could be used to back any position, which she said was never clearer than in the debate last year. Furthermore, the [actuarial] information [in the committee packet] illustrates the vastly different estimates. However, she surmised that everyone would agree the market was different a few years ago when temporary financial circumstances were used to insinuate a total demise of the retirement system. Mercer's change in actuarial assumptions in 2003 created a distorted view of the crisis. "And thus, I think, was born the 'Chicken Little' approach that served other political agendas and ultimately SB 141 was born," she said. Prior to the legislation of SB 141, there should have been hearings.

MS. SALO suggested the state doesn't have a financial crisis. Part of the solution could be to fund the system to make it sound as well as to make-up for the lack of contributions in the past. Health care cost containment could be part of the solution as well. "I think it's kind of like amassing a huge federal deficit. It doesn't hurt now, it's easy to do now, but it will undoubtedly hurt later," she said.

MS. SALO speculated that the consequences of SB 141 on Alaska education would be negative. The only group likely to be advantaged is those choosing to leave Alaska in mid-career. Ms. Salo asked the committee to introduce legislation to delay the effective date for SB 141 by one year. "Passage of this type of legislation would give the legislature the opportunity to turn a terrible situation into an opportunity to fairly and thoroughly address the real problems of rising retirement obligations," she said. There would be great incentives for those coming together to work to maximize the quality and integrity of the retirement system.

REPRESENTATIVE ROKEBERG asked Ms. Salo whether she was suggesting that there was no problem with the PERS/TRS system.

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MS. SALO clarified her belief that the problem is being exaggerated.

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CATHY CARROLL, elementary school teacher, member of the local teacher's association, reiterated Ms. Salo's testimony of the problem being exaggerated. She agreed that SB 141 should be delayed until a solution is discovered.

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ROBERT SALO, retired teacher and previous TRS Board member, questioned the accuracy of the shortfall predictions. While he was on the Board, they requested an audit of Mercer's actuary and as a result, some of the assumptions were changed. Ironically, SB 141 uses the same actuary to project the future program. He stated there have been years of under-funding on the part of the state and suggested it was wrong to put the burden on current employees. He said the system works when the market is strong.

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REPRESENTATIVE SEATON said for the benefit of listeners off-site:

We are talking about the actuarial audit that had been done in 2002 to change the actuarial assumptions and make them reflect reality. In other words, the healthcare assumption that had been fixed at 7.5 percent increase and wasn't in the realm of the experience or what people anticipated as reality going forward and also the mortality rates being kept at 1984 mortality. We use the longevity...the number of years that people will be retired... to calculate what the liability of the system is for payment.

He asked Mr. Salo whether he felt the assumptions to calculate the payments for future retirees are incorrect

and whether the state truly had as much payment liability to pensioners as speculated in the audit.

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MR. SALO said the actuarial audit is over a year old and it may behoove the state to order a fresh audit on the current assumptions.

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TRINA RICHARDSON, retiree from the Kenai Peninsula Borough School District, expressed concern about both current and future pension shortfalls and fund maintenance.

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CHAIR WEYHRAUCH reminded everyone that the Alaska State Constitution guarantees that benefits cannot be diminished.

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MS. RICHARDSON suggested the state should consider using surplus oil money to supplement the system.

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JOHN CZARNEZKI, Kenai Peninsula Borough employee, asked members to deal with the retirement shortfall.

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MR. CZARNEZKI continued it is the responsibility of both the Kenai Peninsula Borough as well as the State of Alaska to ensure the system is set up correctly. The failure to add funds in the past has led to the current problem. He speculated that the benefits are a major incentive for people to take state jobs and urged the legislature to come up with a long-term solution.

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CHAIR WEYHRAUCH explained his plan to move to expert testimony then return to public testimony later in the meeting.

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DAVID TEAL, Director, Legislative Finance Division, Alaska State Legislature recapped his testimony from the Fairbanks meeting. He referred to a graph in the committee packet showing assets versus accrued liability. The two lines follow together until about 2002 when there is a gap, which is unfunded liability to the tune of \$5.7 billion. Poor investment returns, health care cost increases, and new life expectancy tables are the reasons for the shortfall.

MR. TEAL opined that the unfunded liability doesn't mean much to the retirees due to a guaranteed payment of benefits. Contribution increases cannot be approached with the current employees without legal action. Employers will be hit with higher contribution rates until they hit 50 percent of salary for TRS and 30 percent of salary for PERS. Employer contribution rates are designed to close the gap in 25 years with no cash infusion. "Some people think the legislature had to come up with \$5.7 billion this session, which is not true" he said. These increases will apply significant financial pressure to communities, school districts, and state agencies.

MR. TEAL informed the committee that the state portion of the unfunded liability is about \$2 billion at 35 percent. Adding the university to that brings the state total to about \$2.2 billion. The state could pay the gap using general funds yet if the state simply let the rates go up, about half would be paid with federal and other funds.

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MR. TEAL said that it looks like the state will be filling the school district gap using general funds either now or later because the state pays for most of the cost of K-12 education. He said it makes sense to pay it now to avoid higher costs in the future.

MR. TEAL then referred to page 3 of the committee packet and highlighted that there was no surplus available for FY 05. Fiscal year 06 began with no surplus projected but oil is now much higher than projected and the latest figures show a projected surplus of about \$1.2 billion. However, that's likely to decline as the legislature makes supplemental appropriations. For FY 07 there is a small projected surplus of \$235 million before supplementals. For FY 08 and beyond, expenditures are likely to increase

for PERS, TRS and state contracts. Furthermore, deficits will resurface if oil revenues fall. The bottom line, he stated, is that the state has a one-time surplus of about \$1.2 billion. Although the \$1.2 billion is insufficient to fill the entire \$5.7 billion, using the surplus to reduce the unfunded liability would reduce future costs, he noted. "In effect, spending surplus revenue to fill the gap is savings," he opined.

MR. TEAL moved on to the final issue in fiscal planning and offered that there are three knowns:

- The legislature won't be forced to come up with the entire \$5.7 billion required to fill the gap;
- \$1.2 billion is available to address the problem;
- There will be competing needs and desires for that surplus.

However, the options are only to either spend the money now or save it. Saving it offers more options worthy of discussion, such as depositing money into the Permanent Fund or letting it fall into the constitutional budget reserve fund. Another option is to pay some of the retirement system's unfunded liability. The last option is to capitalize the public education fund, which rolls the surplus forward one year. Both spending and saving require an appropriation, he highlighted.

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MR. TEAL recommended taking the surplus off the table in FY 06 and using it to reduce the budget in FY 07 and to put it all toward the TRS system rather than PERS. That would avoid massive increases to the educational formula.

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REPRESENTATIVE SEATON asked how the interest earned in the education fund compared to the 8.25 percent PERS projection.

MR. TEAL said he did not know.

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REPRESENTATIVE ROKEBERG asked Mr. Teal whether the real and true general fund expenditures for FY 06 budget were approximately \$3 billion.

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MR. TEAL said yes.

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REPRESENTATIVE ROKEBERG asked whether there would be a surplus in FY 07.

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MR. TEAL explained a FY 07 surplus is iffy. He cautioned not to try to budget a year and a half in advance. The vast majority of the surplus is an FY 06 surplus. FY 07 is almost a balanced budget and FY 08 may be back to deficits.

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REPRESENTATIVE SEATON asked Mr. Teal to detail the percentages on his pie chart titled "Figure 2. Shares of Alaska Retirement System Unfunded Liability (\$ billions)."

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MR. TEAL explained. [Please refer to pie chart]. 41 percent is TRS at 3.28 billion, 35 percent is state PERS at 1.69 billion, 12 percent is local PERS at .68 billion, 7 percent is school district PERS at .41 billion, 4 percent is university PERS at .2 billion, 1 percent is other PERS at .051 billion.

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SENATOR WAGONER asked the effect of the five percent decrease in the state's share (each year) the past three years.

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MR. TEAL said it reduces the account. He deferred the exact figure to Melanie Millhorn.

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SENATOR WAGONER asserted it is a matter of reinstating the money and adding the percentage back in for each year that it has been deleted and then continuing. He said that is part of the reason the system went down.

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REPRESENTATIVE SEATON asked whether Senator Wagoner was talking about the reduction in the PERS contribution rate by employers.

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SENATOR WAGONER said yes.

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MELANIE MILLHORN, Director, Health Benefits Section, Division of Retirement and Benefits, Department of Administration, advised that the realized savings to the PERS employers was \$356 million when the rate went from 11.9 to 8 percent. For TRS the contribution rate was 12 percent for a number of years then for two years was lowered to 11 percent for a total savings of \$11 million in 2002 and 2003.

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REPRESENTATIVE CHENAULT asked whether that was the same number that municipalities would have also saved.

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MS. MILLHORN said yes. The savings to the State of Alaska was approximately \$232 million and the remainder would be the savings to the individual PERS employers. She noted that the contribution rate is different for each employer.

MS. MILLHORN referred to her prepared testimony and to Attachment 1, which shows that the PERS employer contribution rate was reduced due to the gains in the system. As a result, the actuary determined the rate for each year. The Board adopted the rate, which translated into \$356 million savings for employers over seven years time. In 1991 the PERS Board adopted a cap upon request by the Municipality of Anchorage [regulation 2AAC3500].

However, SB 141 supersedes the regulation to the extent that it cannot fall below the normal cost rate.

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She related that the normal cost rate for PERS for FY 07 is 13.24 and 14.28 for TRS. For FY 07 the Alaska Retirement Management (ARM) Board adopted a rate of 21.77 for the average calculated rate and for TRS they adopted a five percent increase, which equals 26 percent. So, each system is above the normal cost rate and is compliant with the regulation in force right now. The ARM Board members could repeal the regulation in its entirety if it chose to do so.

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REPRESENTATIVE ROKEBERG understood that SB 141 repealed the regulation. He asked whether he was mistaken.

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MS. MILLHORN responded only to the extent that they cannot fall below the normal cost rate. When the Board met it recognized the existing regulation did not allow it to go above the five percentage point increase.

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REPRESENTATIVE WILSON asked the amount the rate could have been so that there was no loss.

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MS. MILLHORN advised that the ARM Board could have raised the rate all the way to the actuary-determined rate, which is 41.78. The actuarial calculated rate for PERS is 28.19. In the absence of having a valuation, the Division sent a letter to employers letting them know that the valuation had not been formally adopted resolving the PERS/TRS Board and that when the ARM Board met in November and adopted the valuations, the Division told the ARM board that for budgetary purposes they should at a minimum budget a 5 percent increase.

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REPRESENTATIVE OLSON inquired as to the last time there was a request for proposals for actuarial services.

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MS. MILLHORN advised that the ARM Board has recently received a presentation from the new actuarial firm. The actuary told the ARM Board members that they have audited two state pension systems and the audit concluded within one percentage point in the two audits that they have conducted with regard to unfunded liability. Buck Consultants will take the last valuation report and replicate that actuarial valuation report to the degree of comfort and will provide a report on their findings sometime in March [2006]. SB 141 requires a second actuary to review that information before it is finalized.

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CHAIR WEYHRAUCH asked whether the ARM Board had its own actuary.

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MS. MILLHORN advised that the ARM Board has access to the actuary. There will be another RFP conducted and the actuary will report to the ARM Board.

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CHAIR WEYHRAUCH asked whether Mercer was still employed by the state.

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MS. MILLHORN responded that Mercer was under contract until December 2005. She clarified that an experience study will be conducted for every system to determine, based on the last four years of experience, the accuracy of that particular assumption and they might have recommendation for change associated with that. They will also provide a financial analysis on the impacts of change to any of the assumptions and, after review by the second actuary, will be provided to the ARM Board and to the legislature.

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MS. MILLHORN informed the committee of her 14-page analysis included in the packet (also provided to the public), which breaks down the average increases for fiscal years 2007-2012. Attachment 3 is a one-page document rough estimate of the amount of state general funds that are contributed to PERS/TRS by the employer groups outlined. Attachment 4 is a list of the employers that chose to stay at the previously reported (FY 06) rate and which ones chose to use the reduced (FY 05) rate in response to SB 46 where the legislature provided \$18.4 million in relief to 74 PERS employers.

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REPRESENTATIVE KELLY asked Ms. Millhorn whether the direction of some funds was triggered by reports that state funds had gone to the IRS because of problems in some municipalities.

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MS. MILLHORN responded she was not sure on an individual employer basis how their decisions came about. There could be one of two variables. They could pay the FY 06 rate and have that 5 percent added to their assets and it would further reduce their unfunded liability, or the appropriation language allowed the employer to stay at the FY 05 rate and then that 5 percent appropriation that came to the division provided the complete employer contribution rate by individual employers. She suggested Jeff Sinz with the Municipality of Anchorage could provide further clarification.

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CHAIR WEYHRAUCH asked Gail Schubert to inform the committee about the ARM Board.

GAIL SCHUBERT, Chair, Alaska Retirement Management (ARM) Board, introduced herself:

The ARM Board was created by the passage of SB 141 and became effective on October 1, 2005. The Alaska State Pension Investment (ASPI) Board served in a transitional role until the ARM Board was officially appointed by the Governor and seated. The ASPI Board managed investments,

drafted and adopted regulations relating to the nomination of bargaining unit members to the ARM Board and also approved the issuance of the request for proposals to hire a new actuary for the ARM Board.

I'm very appreciative of the work done by the state to ensure smooth transition from one Board to another. In early October the Governor completed the appointment of trustees to the Board. Two trustees are ex-officio members of the Board, the Commissioners of Revenue and Administration. [Introduction of members] The first meeting of the Board was held in Anchorage October 11th and 12th. At that meeting officers were elected, a review of SB 141 was provided by Department of Revenue staff, and the fiduciary and statutory responsibilities of trustees were described by legal council. The ARM Board formally accepted fiduciary responsibility to manage the assets of the systems. The state's actuary did a presentation on actuarial principles. The actuary presented the 2004 actuarial valuation report for PERS and TRS. We also heard from the Department of Revenue on a presentation on planned assets.

We set the fiscal year 2007 contribution rate at 21.77 percent and 26 percent for TRS. Both rates are five percent greater than the fiscal year 06 rates. We established a menu of investment options for the new defined contribution planned that will be offered to new employees starting July 1, 2006. We also continued the contracts of three investment advisory council members. We reviewed capital market assumptions and the PERS/TRS asset allocation target. We agreed to hire Buck Consultants as the new actuary. We continued the investment policies previously adopted by the ASPI Board with a commitment to review them systematically over time. Finally we also reviewed a report that for the fiscal year 05 the PERS earned 8.95 percent and TRS earned 9.01 percent gross of fees.

MS. SCHUBERT continued by explaining after fees and expenses the funds experienced an actuarial gain on

investments last year but that employer contributions were less than the actuarial computed rate and she expects that when the FY 05 valuation is completed the funding ratio will fall again. She then detailed what occurred at the Board's second meeting on November 29th and 30th. At the meeting the Board heard reports from four investment managers and a presentation from Buck Consultants, the state's new actuary. One of the things that Buck will do is to replicate the FY 04 valuation completed by the previous actuary. It's anticipated that the replication will not be complete until late February 2006. Completion of the June 30, 2005 actuarial valuation is not anticipated to be completed until March 2006. The Board does not anticipate an experience analysis with the actuarial cost impact until June.

MS. SCHUBERT continued:

The Board also received a preliminary earnings estimate for the period ending September 30, 2005. The preliminary earnings estimate for the first quarter of fiscal year 2006 for PERS is 4.13 percent gross of fees and expenses and 4.14 percent for TRS. One of the requirements of SB 141 is that the Board provide the legislature with a report that includes a preliminary assessment of the financial health of the retirement plans, an assessment of the actuarial services purchased by the Board, recommendations for additional legislative or administrative policy to improve the financial health of the retirement plans, and short-term and long-term recommendations for addressing the unfunded liabilities of the plan.

MS. SCHUBERT advised the committee that she has appointed a committee of four Board members to begin work on the report.

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It is clear that the under-funding problems of the system did not occur overnight and there are no easy solutions but, she indicated, she is confident that the ARM Board trustees have the experience and knowledge to identify the approach to fully fund the obligations to public employees with minimal impact on services.

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REPRESENTATIVE SEATON asked whether the ARM Board is still using the 1994 mortality table and whether there is an anticipated longevity increase if updated to 2004.

MS. SCHUBERT relayed they are still using 1994 and deferred to Ms. Millhorn.

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MS. MILLHORN explained there is another mortality table available for 2000 and the actuary will review it.

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MR. SEMMENS, Finance Director, City of Kenai, referred to a number of graphs in the committee packet and reviewed them with the committee. The graphs show the history of contribution amounts by the City of Kenai and of rates percentages. The graphs show that the City of Kenai was unprepared and unaware of the impending PERS shortfall, which in the coming years will certainly impact services in Kenai.

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MR. SEMMENS concluded by saying that all Alaskans thought they were putting the correct amount of money into retirement. Unfortunately, the actuarial projections that indicated an over-funded status were incorrect. Normally in a budget crisis there are two tools that can solve the problem: Cut expense and raise revenue. The "cut" tool is unavailable because of a constitutional guarantee of benefits, which leaves only the "raise revenue" tool. Another option is to pay down the debt now but there are risks in that too. There will be little public support to use the Permanent Fund to pay down the debt but it may make sense in this case. He continued to say:

Another idea is [to] create a matching grant program where, in order to receive PERS aide, municipalities would have to pay last years five percent increase out of their own resources. If a municipality pays the full ten percent increase from their own resources then they would get the

ten percent match from the state along with a two percent incentive contribution. The biggest benefit of this idea is that it gets more money into the retirement system, which reduces the unfunded liability and future rates. It also gets municipalities used to the idea that they are going to have to fund higher rates and it rewards those that make the hard choice to pay down this liability now rather than pass it on to others in the future.

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CHAIR WEYHRAUCH asked Mr. Semmens whether the City of Kenai would be willing to make a substantial contribution to reduce the unfunded liability if it meant not getting money for roads, capital projects, and municipal revenue sharing.

MR. SEMMENS replied that his recommendation to the City of Kenai would be to strongly consider using available resources to pay down their debt.

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MR. SEMMENS expressed his concern that if state revenue declines, the PERS aid will disappear. If it disappears in 2008, the municipalities will see a 15 percent increase in the cost of their employees.

CHAIR WEYHRAUCH asked Mr. Semmens what he thought of Mr. Teal's recommendation that the money go to TRS instead of PERS.

MR. SEMMENS said he appreciated Mr. Teal's analysis.

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WALTON SMITH, former city manager, St. Marys, testifying on behalf of Richard Alstrom, said the city of St. Mary decided to withdraw from PERS when city managers realized that its unfunded PERS liability would continue to increase while general revenue was decreasing. He said when the city decided to withdraw from PERS, its published unfunded liability was [estimated to be] \$144,000. By the time, the city actually withdrew from PERS, the published unfunded liability had increased to about \$165,000, which was still manageable for the city. The city waited for over a year

for a study, which their termination liability was actually near \$500,000.

He said he was never told that every community that had withdrawn from the PERS program had faced an actual termination liability that was much higher than their estimated unfunded liability at the time of their decision to terminate. He said, furthermore, that since communities cannot estimate their termination liability until after their termination, they are not able to make responsible decisions regarding their participation in PERS. He urged the state to try and determine why termination liability is always much greater than unfunded liability and to provide this information to communities.

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CHAIR WEYHRAUCH asked the witness to submit his testimony in writing.

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RICHARD CAMPBELL, Director, Kenai Pension Board, testifying on behalf of the Mayor of Kenai. Said municipalities should consider how they intend to fill the PERS and TRS shortfall in the event that the state cannot assist them.

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JEROME SELBY, Mayor, Kodiak Island Borough, suggested the legislature cap PERS and TRS contribution levels at 20 percent, that it deal with unfunded liability as a separate, dead issue, and that it allow municipalities to decide how to manage their PERS debt. He recommended that the legislature put \$300 to \$400 million of the existing budget surplus into PERS and TRS to start addressing problems.

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REPRESENTATIVE SEATON asked if Mayor Selby is requesting that the legislature allow local communities to issue bonds at rates lower than 8.25 percent to finance their PERS liabilities.

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MR. SELBY said he is requesting that the municipalities be given the authority to sell bonds at whatever rates that they could get rather than the arbitrary rate of 8.25 percent.

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JEFFERY SINZ, Chief of Finance, Municipality of Anchorage, said the actuaries that analyzed the changes that took place between 2001 and 2002 used radically different methods of analysis and came to radically different conclusions. This demonstrates the importance of considering the differences between various methods of actuarial analysis.

He said, for example, that the term 'fully funded' has different meanings within different perspectives and it is more useful to work within the perspective of a plan administrator, which allows for uncertainties, than it is to work within an accounting perspective, which insists on exact 100 percent coverage and often leads to unrealistic planning. He related the following with regard to the PERS situation in Anchorage:

According to the 2003 evaluation, the unfunded liability for the municipality of Anchorage is \$229 million. Like the City of Kenai, we view this as a debt obligation of sorts. It also happens to be one of the most expensive debt obligations that we have because it comes with a rate of interest of 8.25 percent.

In fiscal 2004, the contribution rate for the Municipality of Anchorage was 3.7 percent. That number is now in excess of 28 percent. The PERS obligation for the Anchorage School district has an unfunded liability of \$145 million. They began in 04' with a contribution rate of 9.3 percent and they are headed for 26.1 percent as of the 05' evaluation. To put those numbers in perspective, the Municipality of Anchorage liability of \$229 million represents roughly 8 percent of the total PERS liability, whereas the school districts 145 million is about 5 percent of that PERS unfunded liability.

The annual cost associated with the increase for the municipality from the 04' rate of 3.7 percent to an actuarial rate of 24.9 percent is about \$28 million per year. The tax-supported portion of that is about [\$]21.3 million. That has an area wide property tax equivalent of about \$1 million. The average value of a single family, owner occupied, residential property within the municipality is about \$220.2 thousand and that produces a tax impact of roughly \$220 per year per single family residence in the municipality.

The municipality has no ready ability to produce revenue to pay for these. Under the municipal tax limitation, the tax levy from year to year is limited, in basic terms, by increases in the CPI for the prior year in the five-year average change in the population. For the most part, increases in cost above what would be typically associated with the CPI have to be offset by reductions in other areas in our budget. When we look at a 28 million dollar a year impact, we view that as a mandate to reduce other costs within our budget by about that same amount.

MR. SINZ said the Municipality of Anchorage believes it will be necessary to address the problem in a number of ways. The Municipality recommends the State of Alaska initiate a one-time buy down of unfunded liabilities. It also suggests the implementation of a maximum annual contribution of a given amount, such as 20 percent, which is the amount suggested by the Alaska Municipal League.

The implementation of a maximum annual contribution rate could address the concern that a period of negative growth could radically increase the cost of benefits and thus the cost of public employees. If this occurs, local governments will attempt to manage the costs by outsourcing services to external contractors. This would shrink the base of employees contributing to the system thus putting more pressure on local governments to further reduce costs, which would thereby create a downward spiraling effect.

MR. SINZ suggested one indirect solution is the facilitation, at the state level, of pension obligation debt similar to that proposed in HB 278. He said the type of legislation is facilitation legislation, which does not

require anything, but rather creates a mechanism for participating entities to do something at the local level.

This type of legislation provides structure and expertise for the issuance of debt and overcomes a constitutional problem associated with the use of general obligation debt for purposes other than capital improvements.

[3:53:29 PM](#)

RICK GIFFORD, Manager, Kodiak Island Borough, said that like Anchorage, his borough has a citizen imposed tax cap which makes it difficult to raise taxes. He endorsed Mayor Shelby's suggestion that the solution must be a shared responsibility between the municipalities and the state.

[3:56:17 PM](#)

REPRESENTATIVE SEATON noted that the City of Kodiak put state PERS relief money towards their PERS debt, but the Kodiak Island Borough used its PERS money for something else. He asked how the state could assure that the money that it issues for PERS relief actually goes to PERS relief instead of for other projects.

MR. GIFFORD said the municipalities must, at some level, budget and pay for some of their PERS burden but they often must address other needs as well such as their failing infrastructure.

REPRESENTATIVE SEATON asked how to approach the problem so that the state does not just pick up the bill for the voluntary unfunded liabilities of municipalities instead of those created by the actuarial assumptions within the PERS system.

MR. GIFFORD replied:

That is a difficult question because you have municipalities that have, through one way or another, created permanent funds. I think that they were looking at forward funding and forward needs and they need to be recognized for having done that and not necessarily be penalized. I also think that this should be a shared responsibility and municipalities like that

should step forward a fund part of this liability.

4:00:12 PM

MELODY DOUGLAS, Chief Financial Officer, Kenai School District, stated her concern about the ability of the Kenai Borough Assembly to continue to fund local contributions at the cap. She estimated the cost at the TRS rate for the retirement system alone will represent about 13.5 percent of the Kenai School District's general fund budget for FY 07'. She made the following recommendations:

- 1) Reevaluate all actuarial assumptions and estimates.
- 2) Establish a maximum employee contribution rate for the PERS and TRS system.
- 3) Continue to control guaranteed health care costs
- 4) Pass legislation to allow municipalities and boroughs to issue pension bonds for rates lower than 8.25 percent.
- 5) Continue to offset the 5 percent increases for all public entities until a solution is determined.
- 7) Use some of the state's oil revenue this year to pay for the state's unfunded debt.

4:03:10 PM

REPRESENTATIVE CHENAULT asked whether the witness recommends that the state continue to pay the five percent increase.

MS. DOUGLAS replied that, that is what she is requesting.

REPRESENTATIVE CHENAULT asked whether the money should be earmarked for PERS and TRS liability exclusively.

4:03:28 PM

MS. DOUGLAS said she did not have the knowledge necessary to answer that question.

4:04:16 PM

REPRESENTATIVE CHENAULT remarked that if state money earmarked for municipal PERS and TRS relief is not going into the PERS or TRS system it should not be labeled as such.

JERRY PATTERSON, former tourism board member, said that according to a Mercer study, the TRS fund will be depleted by 2026 and the PERS fund will be depleted by 2034. He said when the funds are depleted, about 30,000 members will be receiving retirement benefits and paychecks at the cost of about \$1 billion per year. He said that despite current talk about contribution rates, the state will end up assuming the liability for all of it because the contribution pool will diminish as employees retire until it becomes non-existent.

MR. PATTERSON said the committee should ask the actuary what liability the state will have once the funds run out. He said that it would be prudent for the state to devote money to the system now because once the principal of the fund is used, there will never be another time in which its earnings will accrue.

[4:09:39 PM](#)

REPRESENTATIVE SEATON said the contribution rate on employers for the past service cost is drawn from the entire wage base, which is growing at one percent a year, so the systems will not be unfunded even though there is no past service cost associated with tier four employees individually. Therefore, the situation that was just described should not occur.

[4:10:35 PM](#)

SAM TRIVETTE, President, Retired Public Employees of Alaska, said although the PERS and TRS funds have received less than 100 percent funding for most time over the past 25 years, the funds have always returned to 100 percent funding levels. He said this was the result of overstated projections that arose from inaccurate actuarial assumptions. It is well established that the rising cost of health care is causing the problem with the PERS and TRS funds and if the legislature wants to address this issue they must give the ARM committee Board authority over spending. He said the previous cooperative efforts of retirement and benefits, the former PERS and TRS Boards retiring organizations, and the health care administrator have produced millions in savings annually. Given these savings and the probable inaccuracies in the actuarial

projections, the PERS and TRS funds should not be considered to be in a state of crisis.

MR. TRIVETTE strongly urged the committee to use some of the additional surplus money earned this year to pay down the unfunded liability for all of the regions represented in the meeting. He said the violation report that was given to the ARM Board in October of this year was written before SB 141 was ever even in committee and the results of SB 141 were not considered. He said at this point we do not have an actuary report that even takes the impact of SB 141 into account and this is something that the state must do before proceeding with legislation.

[4:14:42 PM](#)

JAY DULANY, Executive Vice President, Retired Employees of Alaska, represented himself as a PERS retiree. He said according to a recent attorney general's opinion the ARM Board has no control over how the trust funds are spent by the Division of Retirement and Benefits (DRB). It thus appears that the Board is given responsibility for oversight for the trust funds without the ability to control its liabilities. He suggested that the legislature consider removing the DRB from the Department of Administration (DOA) and form a retirement and benefits authority under the ARM Board.

[4:19:11 PM](#)

REPRESENTATIVE SEATON said he wants to address the distinction between voluntary unfunded liabilities and liabilities that are the consequences of actuarial assumptions. He voiced concern about communities that pay municipal and school board members a very low rate and allow them to access the PERS system by making very small contributions. He noted in the case of Homer these practices have created a long-term liability of \$300,000 to \$400,000 per employee. He cautioned the communities that have adopted such practices that the state may not pick up those voluntary unfunded liabilities in the way that it picks up those created by actuarial assumptions.

CHAIR WEYHRAUCH announced that the meeting was approaching its scheduled end and discussion on the topic would be resumed at the next meeting.

4:22:09 PM

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 4:24:19 PM.