Finance Department

Presentation to the City of Houston Budget and Fiscal Affairs Committee

Pension Update

March 3, 2015

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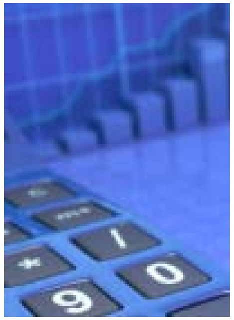
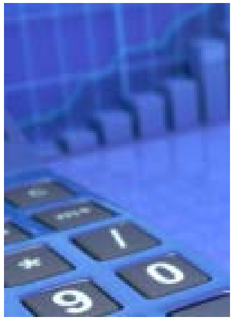
Craig Mason, Presenting



AGENDA

- Impact of Change in Actuarial Assumptions at HPOPS
- GASB 68 Implementation
- Effect of benefit changes on future plan costs
- Questions

HPOPS Actuarial Assumption Changes



- **The cost of a pension plan = the benefits paid minus the net investment income earned.**

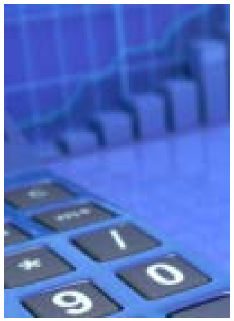
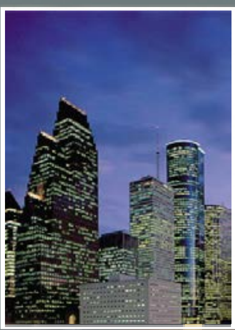
- **To estimate the cost and to determine annual contribution amounts an actuary must make certain assumptions regarding future events:**
  - Rate of return on investments
  - Salary increases
  - Turnover
  - Mortality and disability
  - Incidence of retirement

- **Assumptions are not static:**
  - Should be monitored periodically and changed accordingly
  - Assumption changes do not change the cost – just the timing of contributions

- **HPOPS has prudent fiduciary policy to review assumptions every 5 years:**
  - Commissioned its actuary to conduct a review in 2014
  - Actuary recommended changes for the actuarial valuation as of July 1, 2014
  - HPOPS board adopted the recommended changes

HPOPS Summary of Significant Assumption Changes

Assumption	Change	Impact on Liability
Investment Rate of Return	Reduce from 8.5% to 8.0%	Increase
Salary Increases	Reduce by 0.5% per year	Decrease
COLA	Reduce from 2.8% to 2.7%	Decrease
DROP Interest Rate	Reduce from 7.0% to 6.4%	Decrease
DROP/PROP Payout	From Immediate to 10 Year	Decrease
Turnover	Lower Slightly	Increase
Mortality	Update for Improved Mortality	Increase
Incidence of Retirement	Increased Expected Age at Retirement by About 1 Year	Decrease

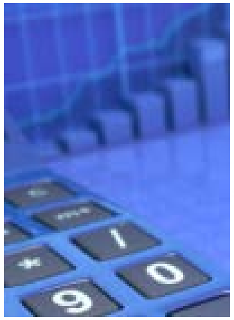

HPOPS – Impact on Funding

- City contribution schedule set by Meet & Confer Agreement:
    - $113 million for FY 2015
    - Increases by $10 million each year in future
    - Additional contribution if Funded Ratio (current assets/current Accrued Liability) falls below 80%

- Additional contribution approximately $50 million for each 1% Funded Ratio is less than 80%

- 2014 change in assumptions more conservative (realistic?) estimate of plan's cost:
    - Increased ARC rate from 35.1% to 38.2% of payroll
    - Increased UAL from $942 million to $1.021 billion
    - Decreased Funded Ratio from 82.2% to 81.0%

- Funded Ratio remained above 80% due to investment rate of return of 17.3% for FY 2014

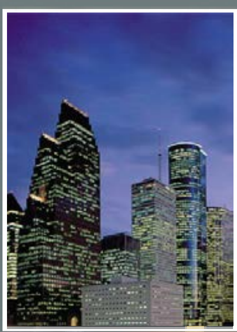


HPOPS Outlook

- **IF** assumptions are met, actuary projects:
  - Scheduled City contribution rates will increase from 27% to approximately 38% of payroll after FY2026
  - Scheduled City contributions will be greater than the ARC beginning about FY2021
  - The ARC rate will decrease to about 18% over the next 20 years
  - The Funded Ratio will remain above 80%
  - Plan will be funded on financially sound basis

- **BUT** Funded Ratio will fall below 80% and trigger additional contribution for FY2017 **IF** 0% rate of return for FY2015

- FY2015 year to date rates of return for all three city plans now at 0% +/- 2% points



GASB 68 Implementation

- City must comply with GASB 68 for FY2015.

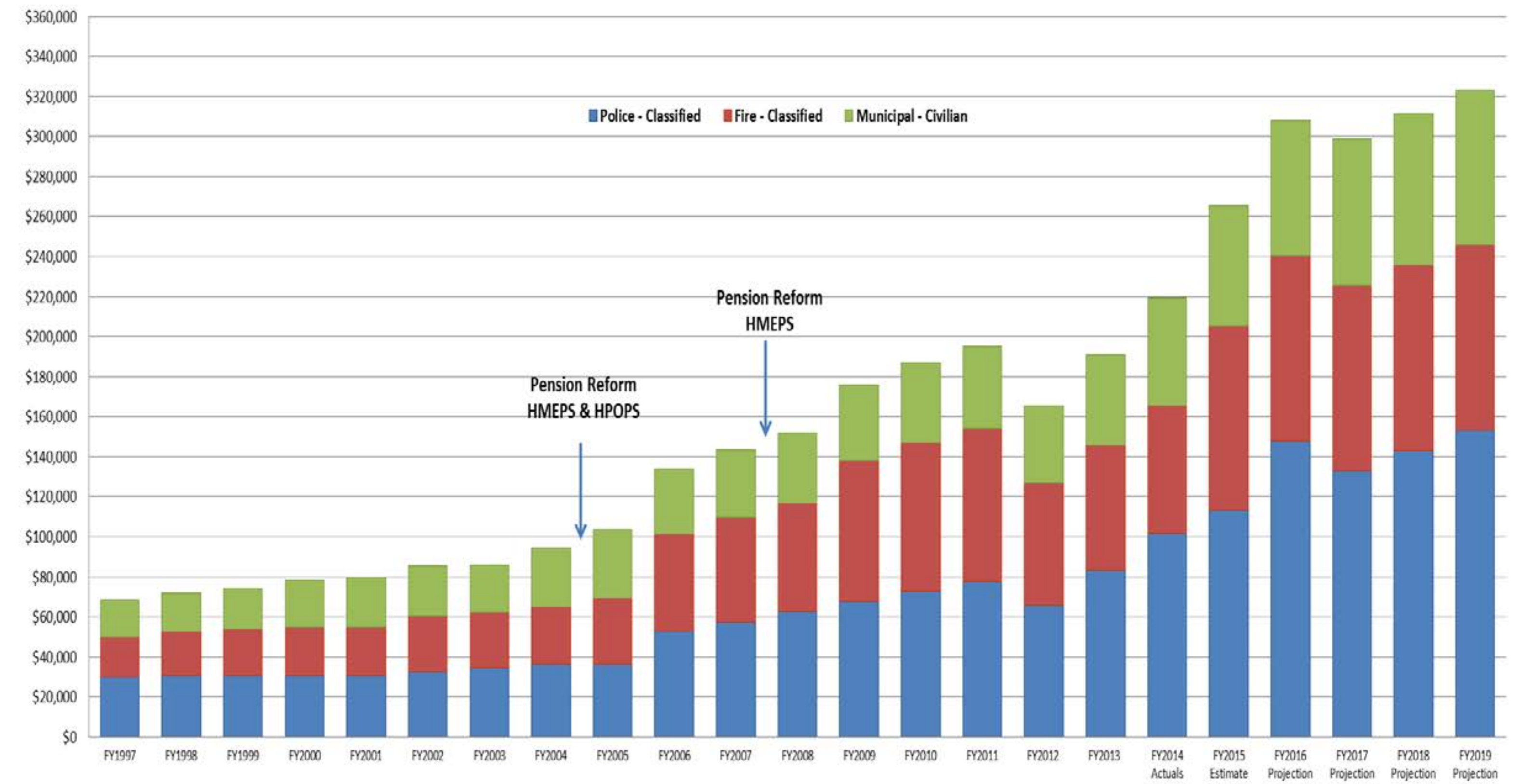
- Financial reporting under GASB 68 bears no relationship to funding policy or contributions.

- Major changes for measuring and reporting pension liability are:
  - A single actuarial method for calculating the liability is mandated
  - The liability is reported directly on the balance sheet

- If in effect for FY2014 pension liability on the City's balance sheet would have been $3.896 billion:
  - HPOPS – $1.651 billion
  - HFRRF – $0.343 billion
  - HMEPS – $1.902 billion

- Required use of market value of assets to offset the Accrued Liability:
  - Expected to create more volatility in the reported pension liability amounts
  - The initial liability for FY2015 expected to be significantly larger than the estimated preliminary amounts for FY2014 due to probability of poor investment returns for year

Increasing General Fund Pension Expenditures are Crowding Out Headcount/Services ($ in Thousands)



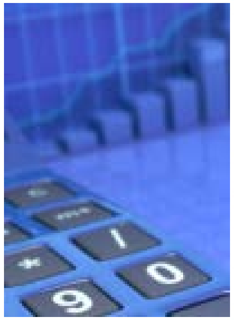
Pension	FY1997	FY1998	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
Police - Classified	$29,731	$30,645	$30,538	$30,551	$30,615	$32,551	$34,532	$36,523	$36,502	$52,697	$57,597
Fire - Classified	$20,175	$21,884	$23,220	$24,093	$24,076	$27,979	$27,772	$28,325	$32,699	$48,738	$51,984
Municipal - Civilian	$18,660	$19,610	$20,317	$23,675	$25,253	$24,812	$23,524	$29,317	$34,437	$32,501	$33,932
Total	**$68,566**	**$72,139**	**$74,075**	**$78,319**	**$79,944**	**$85,342**	**$85,828**	**$94,165**	**$103,638**	**$133,936**	**$143,513**
% Growth	**2.29%**	**5.21%**	**2.68%**	**5.73%**	**2.07%**	**6.75%**	**0.57%**	**9.71%**	**10.06%**	**29.23%**	**7.15%**

Pension	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014 Actuals	FY2015 Estimate	FY2016 Projection	FY2017 Projection	FY2018 Projection	FY2019 Projection
Police - Classified	$62,627	$67,495	$72,669	$77,534	$65,701	$83,526	$101,576	$113,000	$148,000	$133,000	$143,000	$153,000
Fire - Classified	$53,981	$70,506	$74,299	$76,352	$61,204	$62,141	$63,719	$92,458	$92,380	$92,588	$92,789	$92,807
Municipal - Civilian	$35,278	$37,994	$40,017	$41,537	$38,662	$45,219	$53,973	$59,849	$67,728	$73,328	$75,906	$77,252
Total	**$151,886**	**$175,995**	**$186,985**	**$195,423**	**$165,567**	**$190,886**	**$219,268**	**$265,307**	**$308,108**	**$298,916**	**$311,695**	**$323,059**
% Growth	**5.83%**	**15.87%**	**6.24%**	**4.51%**	**-15.28%**	**15.29%**	**14.87%**	**21.00%**	**16.13%**	**-2.98%**	**4.28%**	**3.65%**

- FY2016 includes possible $25 Million HPOPS Payment; potential payments that would be required if HPOPS funding level falls below 80% are not included.

Effect of benefit changes on future plan costs

- In the LONG TERM benefit changes at HPOPS and HMEPS will reduce plan costs and ease budget stress.
- But in the short to intermediate term, the cost of the legacy benefits at HPOPS and HMEPS will continue to place significant stress on the budget.
- Without any change at HFRRF:
  - The cost of HFRRF benefits will continue to cause budget stress in the long term, and
  - Will result in significant disparity in benefit levels versus other city employees.



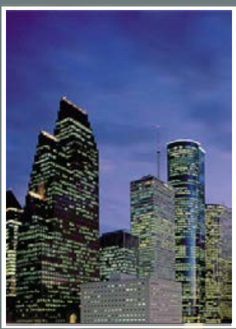


Illustration of Future Retirement Benefits for City Employees
Upon Retirement With 30 Years of Service

	HFRRF (i)	HPOPS (ii)	SS (iv)
1. Initial annuity as a % of pre-retirement salary	91%	75%	50%+SS
2. Estimated additional lump sum from DROP	$750,000	none	none
3. Future automatic cost of living adjustments	yes	yes	no (iv)
4. Employee contribution rate (% of pay)	9.00%	10.25%	6.20%
5. Minimum age eligible for unreduced benefit	none	55	62
6. Overtime included in pay for pension purposes	yes	no	no

(i) Assuming no change in current benefits - % in item 1 from the 2014 CAFR
(ii) Applies to actives hired after 10/9/2004 - 36.9% of current actives
(iii) Applies to actives hired after 1/1/2008 - 33.4% of current actives
(iv) Social Security benefits have cost of living adjustments based on CPI

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Questions?