

Finance Department
Status of the City of Houston Pension Systems

August 9, 2011

Background

During the decade of the 90s, the three pension systems sponsored by the City of Houston (HMEPS, HPOPS, and HFRRF) were funded adequately on an actuarially determined, consistent, and financially sustainable basis with annual contributions from the City of approximately:

- 10% of payroll to HMEPS,
- 17% of payroll to HPOPS, and
- 15% of payroll to HFRRF.

It is important to consider that the members of HPOPS and HFRRF are not covered by Social Security and, therefore, the City does not make FICA retirement contributions of 6.2% of payroll on their behalf.

The period of years 2000 – 2002 was a watershed period for all three of the pension systems in that, during that period, decisions were made and actions taken that resulted in dramatic, undesired, and financially unsustainable increases in the City's pension funding obligations. By 2004 the actuarially determined City contributions had increased:

- From 10% to over 50% of payroll for HMEPS,
- From 17% to around 30% of payroll for HPOPS, and
- From 15% to around 30% of payroll for HFRRF.

Because the increased actuarially determined City contributions were not financially supportable by the City and its taxpayers, an imbalance existed in each system between the promise of benefits and the ability of the City and the pension systems to meet that promise. When such an imbalance exists the security of the promised benefits for the members is jeopardized.

Therefore, beginning in 2004, the City Administration began the process of improving the security of the promised benefits by bringing those pension liabilities (the promise of benefits) into balance with the funding obligations (the ability to meet the promise).

This report briefly summarizes (1) the events during that watershed period (2000-2002) which resulted in the undesirable increases in pension liabilities and the associated unsustainable increase in the City's funding obligations, (2) the steps taken to date to address the unsustainable increases in the City's funding obligations, and (3) the current state of balance, or imbalance, between the promise of benefits and the ability to meet that promise for each system as reported in the most recent actuarial valuation reports.

HMEPS

Cause of Imbalance

In 2001, a decision was made increase benefits payable to members of HMEPS. The decision to increase benefits in HMEPS was made based upon a flawed actuarial analysis of the impact of the benefit increases on the City's future funding obligations to HMEPS. That actuarial analysis, presented for approval by the City and the State Legislature, indicated the City contributions to HMEPS would increase from the current 10% of payroll level to approximately 15% of payroll. However, the subsequent official actuarial valuation in 2003 performed by the HMEPS actuary, after the increased benefits were implemented, indicated that, in order to be able to deliver the increased benefits to employees, the City would need to increase its contribution rate to HMEPS to over 50% of payroll.

Steps Taken to Date to Address the Imbalance (Sustainability)

In early 2004, the City Administration and HMEPS took some immediate, emergency steps to address the unexpected, undesirable, and insupportable increase in the City's funding obligations arising from the revised benefit structure. Specifically, the City Administration and HMEPS, through the "meet and confer" process, agreed to the following changes:

- The City made an extra non-cash contribution in FY2005 of an asset valued at \$300 million,
- The rates of future benefit accruals for current employees were reduced,

- The employees' mandatory contribution rate was increased from 4% of pay to 5% of pay, and
- A schedule of increasing City contributions for fiscal years 2005 through 2007 was adopted.

The effect of these changes on the City's long term funding obligations was to reduce the actuarially determined City contribution rate from over 50% of payroll to about 24% of payroll. Since the 24% rate was still substantially greater than the objective rate of 15% of payroll that was approved by City Council and State Legislature in 2001, the City Administration proposed additional changes in 2007 to further reduce the pension liabilities and improve benefit security by achieving a balance (or sustainability) between the promise (liabilities) and the ability to meet the promise (assets).

The additional changes, agreed upon by the City and HMEPS and adopted in 2007 have provided a more permanent, long-term solution to bringing future City contributions to HMEPS closer to a desired, financially supportable level. These additional changes include:

- Implementing a new significantly lower liability benefit structure applicable to employees hired in 2008 and after, and
- Establishing a schedule of increasing City contributions through fiscal year 2011.

Current Status

In accordance with the 2007 agreement, the City's scheduled contribution to HMEPS for FY2011 is \$88.5 million, which is projected to be approximately 15% of payroll. If no change in funding policy is adopted for years after 2011, the future City contributions will be based on an actuarially determined amount. The City's actuarially determined contribution rates are projected to increase to 22.4% of payroll for FY2012 and to approximately 25% of payroll by FY2015. However, over the long term (30-40 years), the actuarially determined City contribution rate is projected to ultimately decrease to approximately 6% payroll when the full impact of the lower liability benefit structure for employees hired after January 1, 2008 is realized.

HPOPS

Cause of Imbalance

Prior to 2004, some HPOPS members and the HPD/City administration took advantage of certain HPOPS plan provisions, which allowed them to make some "anti-selection" decisions – decisions regarding individual benefits that increased the plan's overall liabilities more than desired. In addition, some compensation changes were made through collective bargaining between the City and HPOU apparently without due consideration of their impact on the pension liabilities in HPOPS. As a consequence of these events, the City's actuarially determined contribution rate to HPOPS increased substantially from approximately 17 % of payroll to approximately 30% of payroll by 2004.

Steps Taken to Date to Address the Imbalance (Sustainability)

The City Administration and the HPOPS board collaborated through a “meet and confer” process in 2004 to make the following changes to bring the system into sustainable balance over the long term:

- Eliminated the plan provisions that were conducive to individual anti-selection decisions;
- Established a new lower liability benefit structure for police officers hired after 10/9/2004; and
- Provided for a schedule of gradual and predictable increasing City contributions to HPOPS over the long term.

Current Status

The FY2011 City contribution to HPOPS is \$78 million, which is estimated to be approximately 19% of payroll. In accordance with the 2004 agreement, the City contribution to HPOPS will be \$83 million in FY2012. And beginning in FY2013 the City contributions to HPOPS will increase by \$10 million per year thereafter. As of July 1, 2010, the HPOPS actuary projects that the scheduled contributions based on the 2004 agreement will accumulate assets sufficient to pay the promised benefits when they are due.

In 2011, the City and HPOPS further agreed that the City's contribution of \$83 million for FY2012 will be made in two parts - \$66 million in cash and \$17 million in real property.

HFRRF

Cause of Imbalance

In 2000, the HFRRF board unilaterally increased benefits (as permitted by the HFRRF Statute) and represented to the City, the State Pension Review Board, and the firefighters that it could deliver the increased benefits with minimal impact on the City's long term funding obligations. The actuarial analysis presented by the HFRRF board indicated that the increased benefits could be funded adequately by continuing City contributions at a rate of payroll approximately equal to the historical rate of two times the member contribution rate, or approximately 18% of payroll. The 2 to 1 ratio of City to member contributions is codified in the HFRRF statute as a minimum City contribution.

However, the official actuarial valuation as of July 1, 2001 completed by the HFRRF actuary immediately after the increased benefits were implemented indicated the impact on the future funding obligations of the City had been significantly underestimated. In fact, based on the 2001 actuarial valuation, the City's long term funding obligation represented by the "normal cost" increased immediately by approximately 60% from 14.0% of payroll to 22.3% of payroll.

And by 2004 the City's actuarially determined contribution had increased to over 30% of payroll, which was double the contribution rate in effect prior to the benefit increase and over 3 times the member contribution rate of 9%.

Steps Taken to Date to Address the Imbalance (Sustainability)

The City has been unsuccessful in taking steps to bring the plan into a state of sustainable balance between the benefits promised and the ability of the fund to meet that promise. The HFRRF statute does not provide for a "meet and confer" process with the HFRRF board and the HFRRF board has been unwilling collaborate with the City to make the desired changes to achieve sustainability.

Current Status

The City's contribution rate is 29.4% of payroll for FY2011 and will be 23.9% of payroll for FY2012 - FY2014. Based on the July 1, 2010 actuarial valuation, the City's contribution rate is projected to increase to approximately 36% of payroll by FY2015. This projected contribution rate is 2.5 times the rate in effect prior to the benefit increases in 2000 changes, 4 times the member contribution rate, and 3 times the median contribution rate from a national survey of plans covering members who are not eligible for Social Security benefits.