



Finance Department

Presentation to the City of Houston Budget and Fiscal Affairs Committee

Study on Options for Addressing City Pension Funding Obligations

February 20, 2014

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AGENDA

- Background
- Current and Projected Funding Obligations
- Options For Reducing City's Long Term Funding Obligations
- Projections of Cost Impact Per Retirement Horizons Inc. (RHI)
- Projected City Funding Obligations For Benefit Change Options
- Questions?



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Background



COH PENSION SYSTEMS - STATUTORY FRAMEWORK

- 3 Separate plans – Civilians, Police and Firefighters
- Administration of plans is outsourced to 3 separate independent Trust Organizations:
 - Houston Municipal Employees Pension System (HMEPS)
 - Houston Police Officers' Pension System (HPOPS)
 - Houston Firefighters Relief and Retirement Fund (HFRRF)
- The administrative/trust organizations are established and governed by separate state statutes to:
 - Manage the plan's investments
 - Pay benefits when due



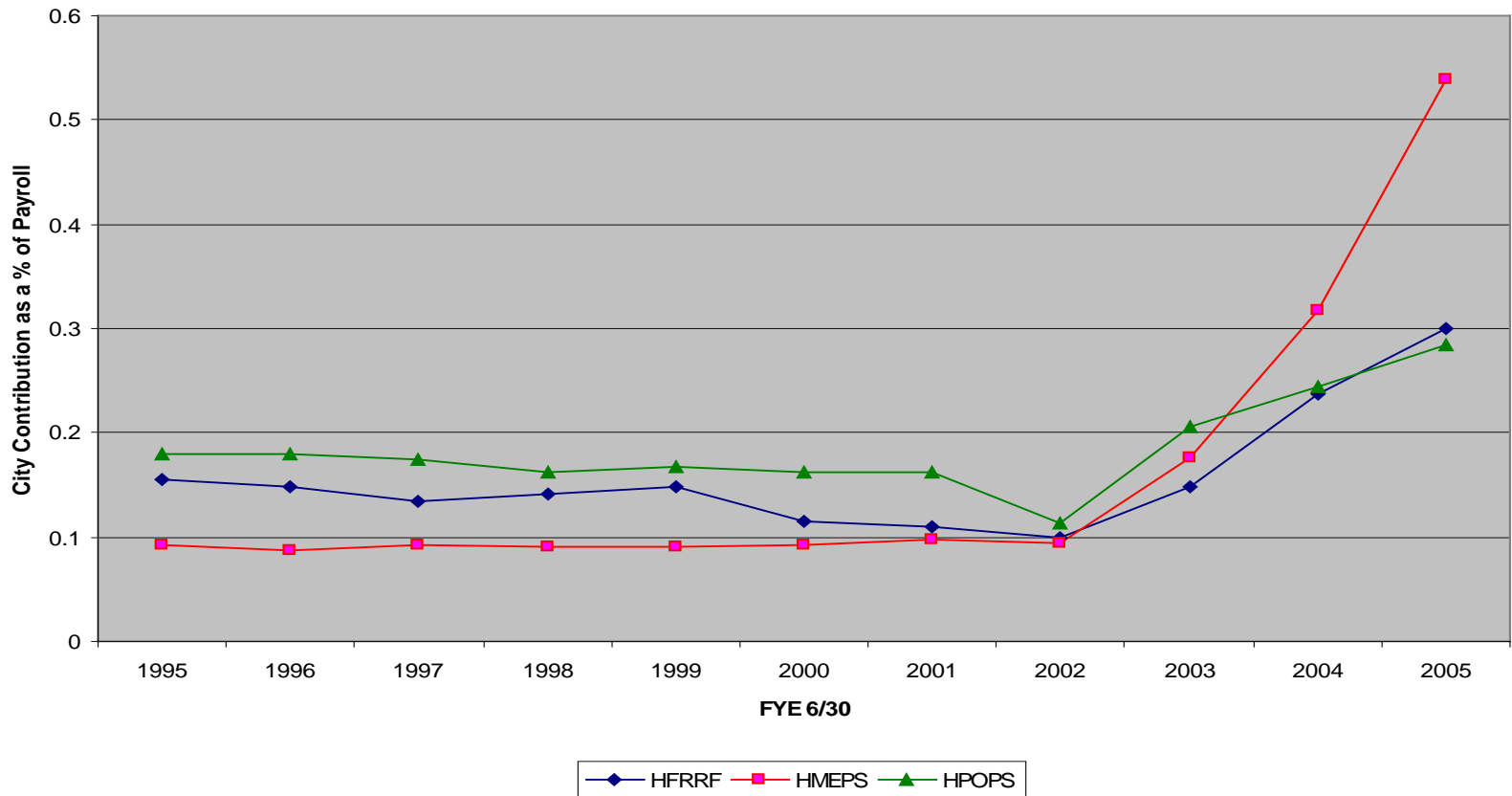
COH PENSION SYSTEMS - STATUTORY FRAMEWORK

- The description of benefits (plan design) is included in the state statutes
- HMEPS and HPOPS have ability to trump state statutes through Meet & Confer with the City
- HFRRF statute does not permit Meet and Confer
- Pension benefits are considered separately from other elements of the City's total compensation program
- The actuary advising on funding and expense options reports to each plan administrator rather than to the City



COH PENSION SYSTEMS THE CHALLENGE – CITY CONTRIBUTIONS INCREASE TO UNSUSTAINABLE LEVELS, 2002-2005

Benefit Decisions in 2000-2002 Increased the Plans' Liabilities Resulting in Unanticipated and Undesirable Increases in City Contributions as of 2005





ADDRESSING HMEPS PENSION CHALLENGES

2004 Meet & Confer Agreement

- Reduced future benefit accrual rates
- Increased eligibility age for retirement from “rule of 70” to “rule of 75”
- Increased mandatory employee contribution rate from 4% to 5%
- Transferred an asset valued at \$300 million to the pension fund
- Adopted a schedule of increasing dollar contributions for FY2005 thru FY2007
- Added 2 Council appointees and a Controller appointee to HMEPS Board

2007 Meet & Confer Agreement

- Adopted new benefit structure for employees hired after January 1, 2008
- Adopted a schedule of increasing dollar contributions for FY2008 through FY2011

2011 Meet & Confer Agreement

- Provided for gradual increase in future contribution rates until equal to Governmental Accounting Standard Board (GASB) – Annual Required Contribution (ARC) rate



ADDRESSING HPOPS PENSION CHALLENGES

2004 Meet & Confer Agreement

- Eliminated provisions conducive to “benefit spiking”
- Adopted new plan for Police Officers hired after October 9, 2004
 - Reduced benefit levels
 - Increased employee contributions (10.25% vs. 9.0%)
 - Minimum retirement age 55
 - No Deferred Retirement Option Plan (DROP)
- Adopted a long term funding policy of gradually increasing City contributions (from approximately 20% of payroll to approximately 35% of payroll over the next few years)

2011 Meet & Confer Agreement

- Provided for a portion of the scheduled contribution for FY2012 and FY2013 to be made with an “in kind” contribution of real estate



ADDRESSING HFRRF PENSION CHALLENGES

- COH has been unable to make any changes to address the challenge at HFRRF



CURRENT AND PROJECTED FUNDING OBLIGATIONS

Projected Contributions and Unfunded Accrued Liabilities (UAL) With No Change in Benefits or Funding Policy

	FY2014			FY2025		
	% Payroll	Contributions (millions)	UAL (millions)	% Payroll	Contributions (millions)	UAL (millions)
HFRRF	23.90%	\$62.40	\$489.60	32.30%	\$121.40	\$727.20
HPOPS	25.80%	\$103.00	\$858.70	35.50%	\$209.40	\$1,841.70
HMEPS:						
Plan	23.40%	\$136.40	\$1,622.70	32.20%	\$235.30	\$2,538.60
Social Security	6.20%	\$36.10	N/A	6.20%	\$45.30	N/A
Total HMEPS	29.60%	\$172.50	\$1,622.70	38.40%	\$280.60	\$2,538.60
TOTAL	27.20%	\$337.90	\$2,971.00	36.10%	\$611.40	\$5,107.50

Projected contributions to HPOPS do not consider the 80% funded ratio trigger
Contribution rates in FY2025 = the ARC rates



OPTIONS FOR REDUCING CITY'S LONG TERM FUNDING OBLIGATIONS

Primary Objectives

- No reduction in accrued benefits for active employees
- No reduction in benefits currently being paid to retirees
- Achieve sustainable, competitive benefits within City's budget parameters

Two Scenarios Analyzed

- Changes applied only to future members
- Changes applied to both current and future members

Benefit Change Options Analyzed

- Eliminate automatic future Cost of Living Adjustments (COLAs)
- Reduce automatic future COLAs to 1%
- Freeze DROP accounts
- Eliminate future interest credits to DROP accounts
- Increase the eligibility age/service for retirement – Age 55/10 for HFRRF and age 65/5 for HMEPS
- Reduce automatic post-retirement survivor benefit to 50% (future retirees only for HFRRF and HPOPS)
- Adopt HPOPS plan design applicable to “new” HPOPS members for “new” HFRRF members



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RHI Study



CITY ENGAGED RHI TO ANALYZE IMPACT OF OPTIONS

- The City engaged the actuarial firm of Retirement Horizons Inc. (RHI) to analyze the long term cost impact of certain benefit elements in the current pension plans
- Using demographic summaries of employee data included in the pension funds' actuarial valuation results as of July 1, 2012, RHI was able to duplicate the funds' actuarial results for that year with a high degree of accuracy. For example, the differences in the City's actuarially calculated contribution rates for the actuarial valuations as of July 1, 2012 were:
 - HFRRF – RHI Rate of 31.7% vs. Fund Actuary's Rate of 31.1%
 - HPOPS – RHI Rate of 35.1% vs. Fund Actuary's Rate of 34.5%
 - HMEPS – RHI Rate of 26.3% vs. Fund Actuary's Rate of 26.1%
- The RHI results were used as a baseline for projecting the long term cost impact of the various benefit elements
- The projections were made using the actuarial methods and assumptions used by the pension funds' actuaries for determining the City's funding obligations
- The projections are deemed to be reasonable estimates for evaluating the long term cost impact of the plan features

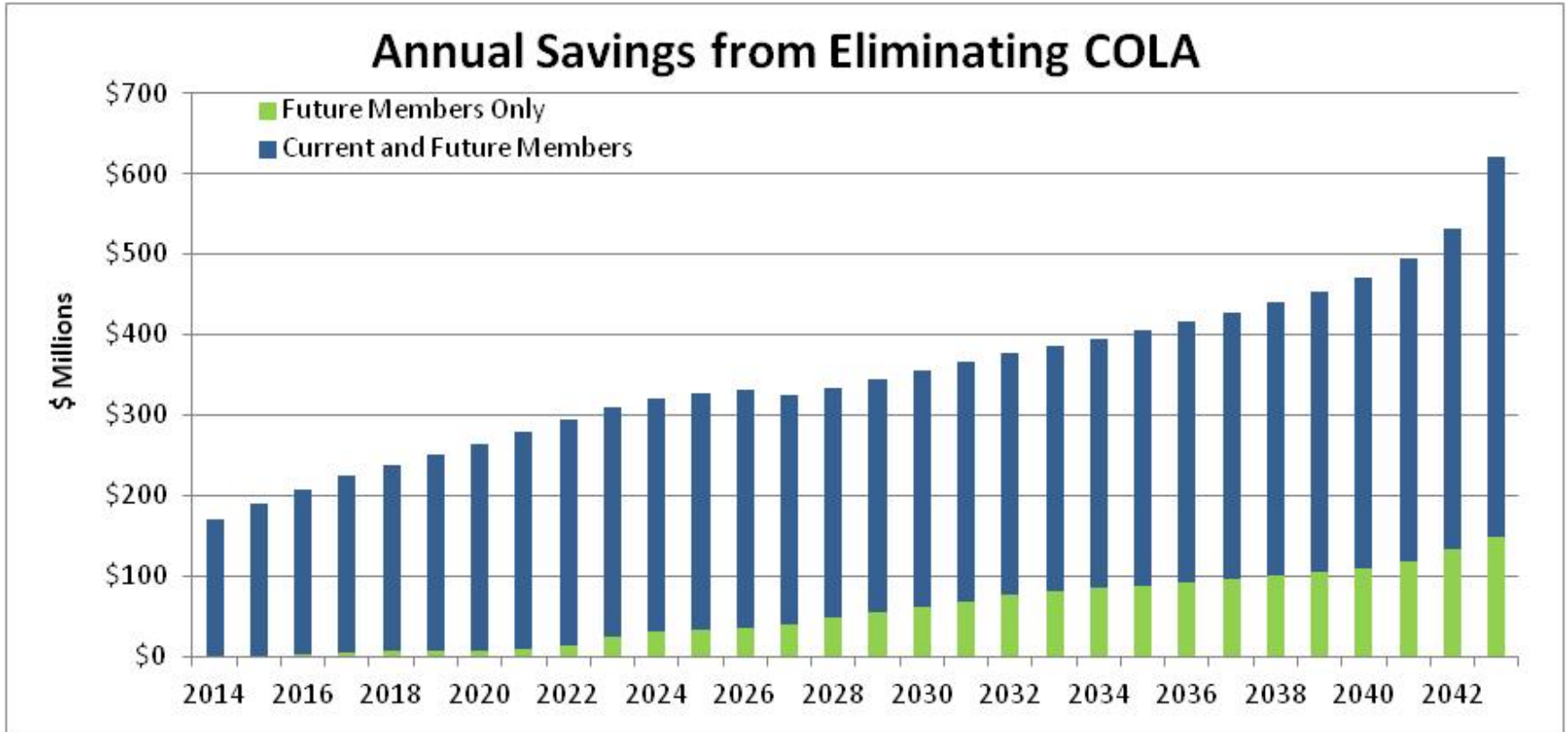


OBSERVATIONS REGARDING COST SAVINGS PROJECTIONS

- Cost Savings not significant for 20 – 30 years if benefit changes apply only to future members
- Automatic COLA, which affect the greatest number of members is the most costly benefit element analyzed, and therefore a change would result in the greatest cost savings
- The DROP option is the second most costly benefit element analyzed, so a change would result in a significant cost savings for both the near and long-term
- Projected costs would be higher if the future rate of return on investments is less than 8.5%
- Some changes likely to influence employer's retirement decisions which may result in short term staffing issues and necessitate a change in the future assumed retirement ages
- The following slides illustrate the annual savings for the described options

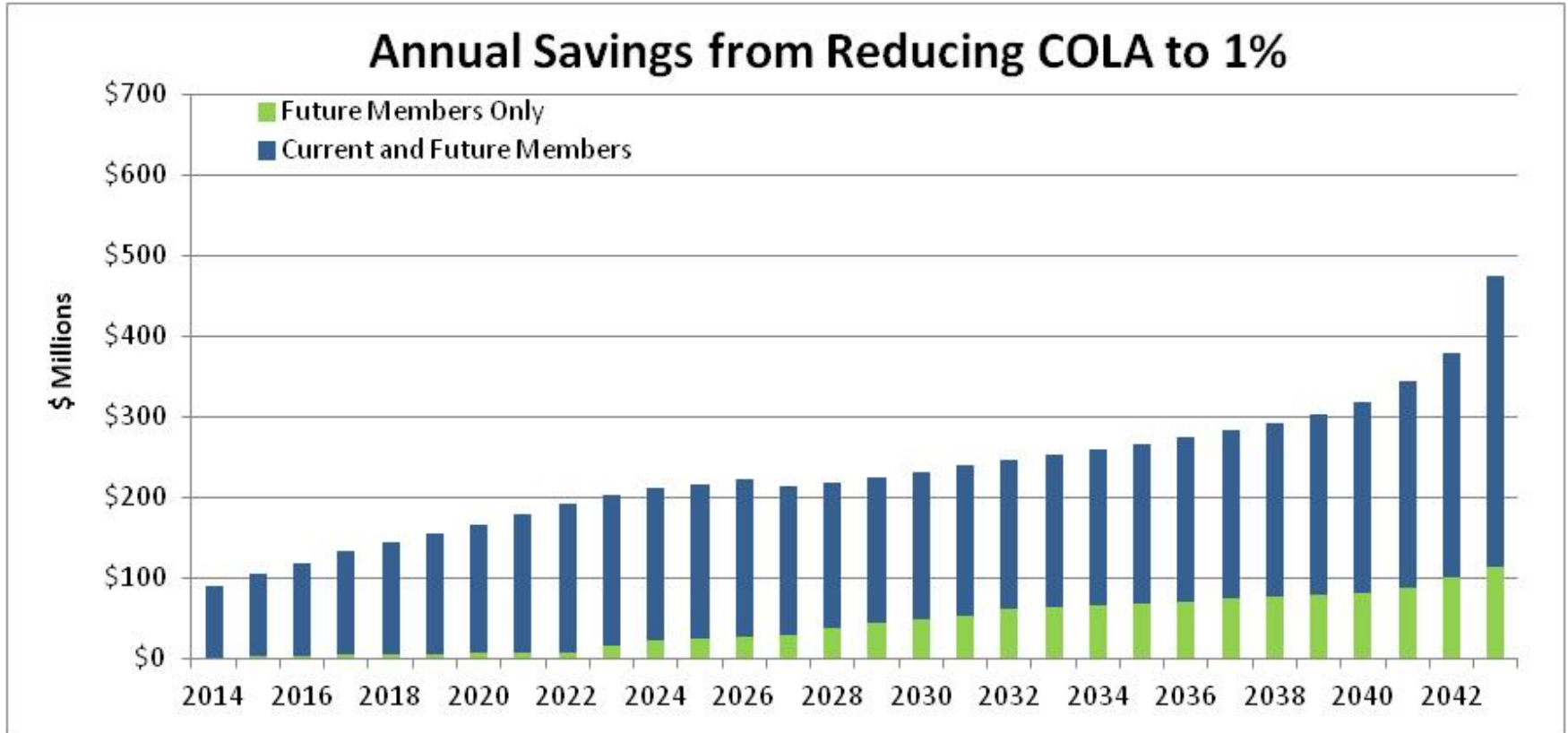


ELIMINATING COLA



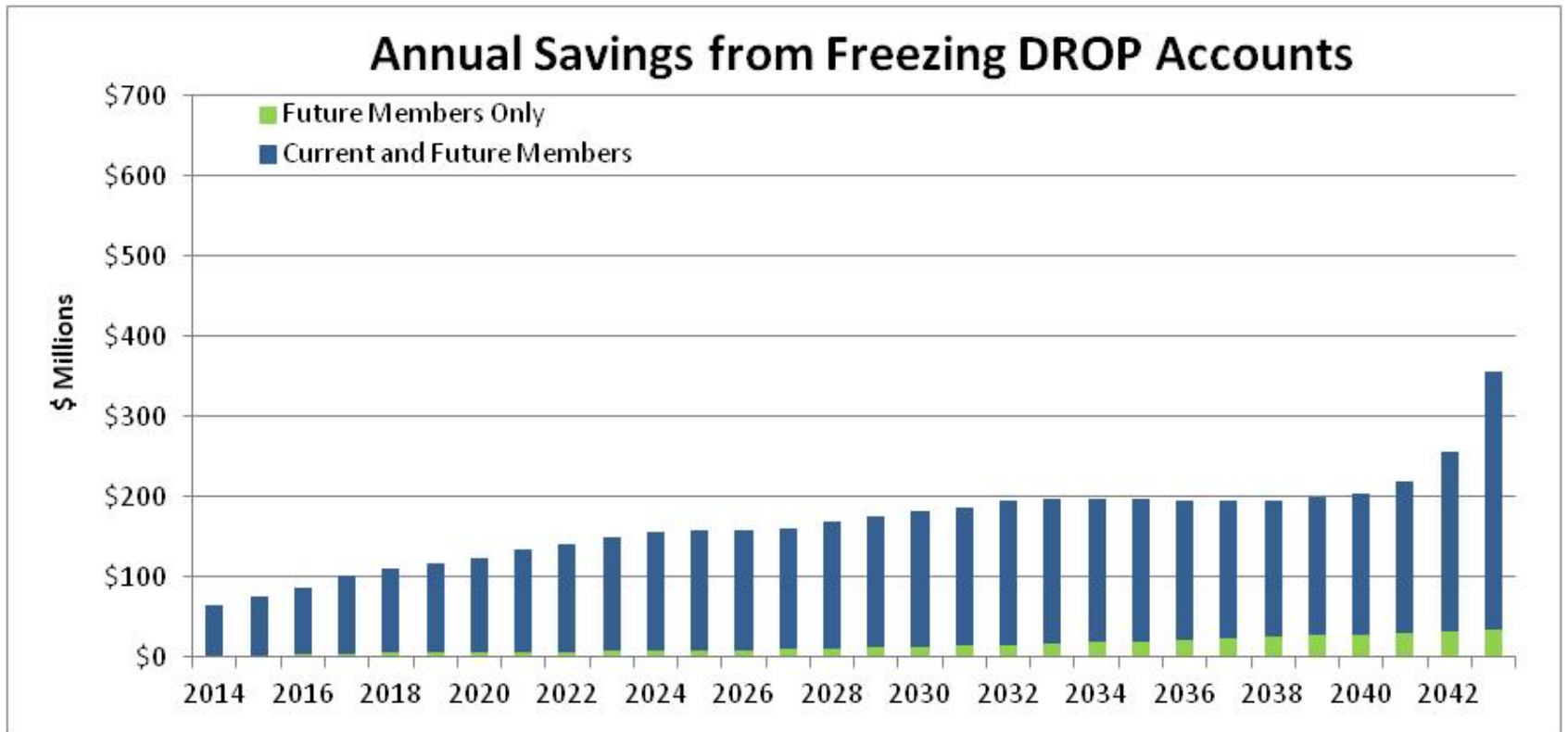


REDUCING COLA



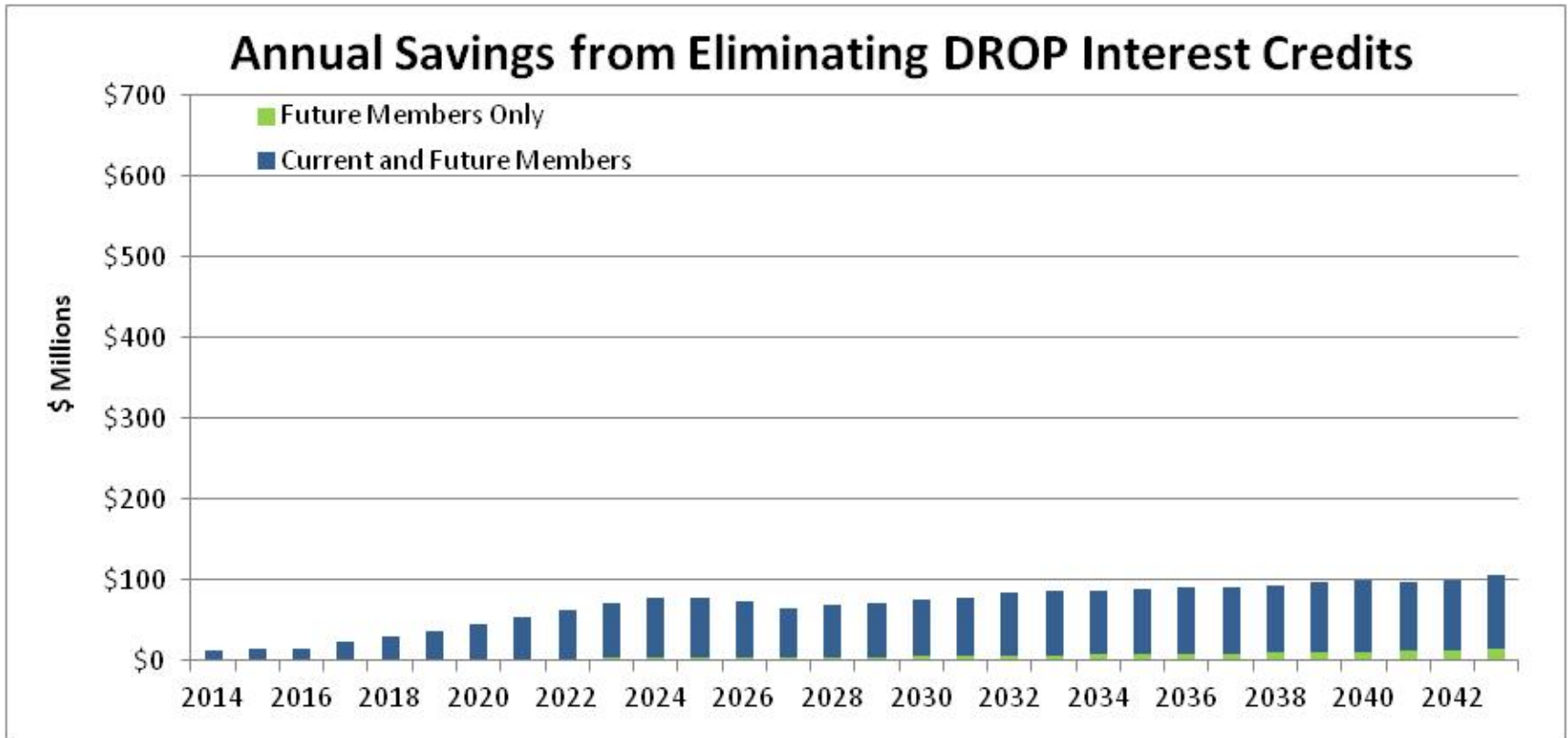


FREEZING DROP ACCOUNTS



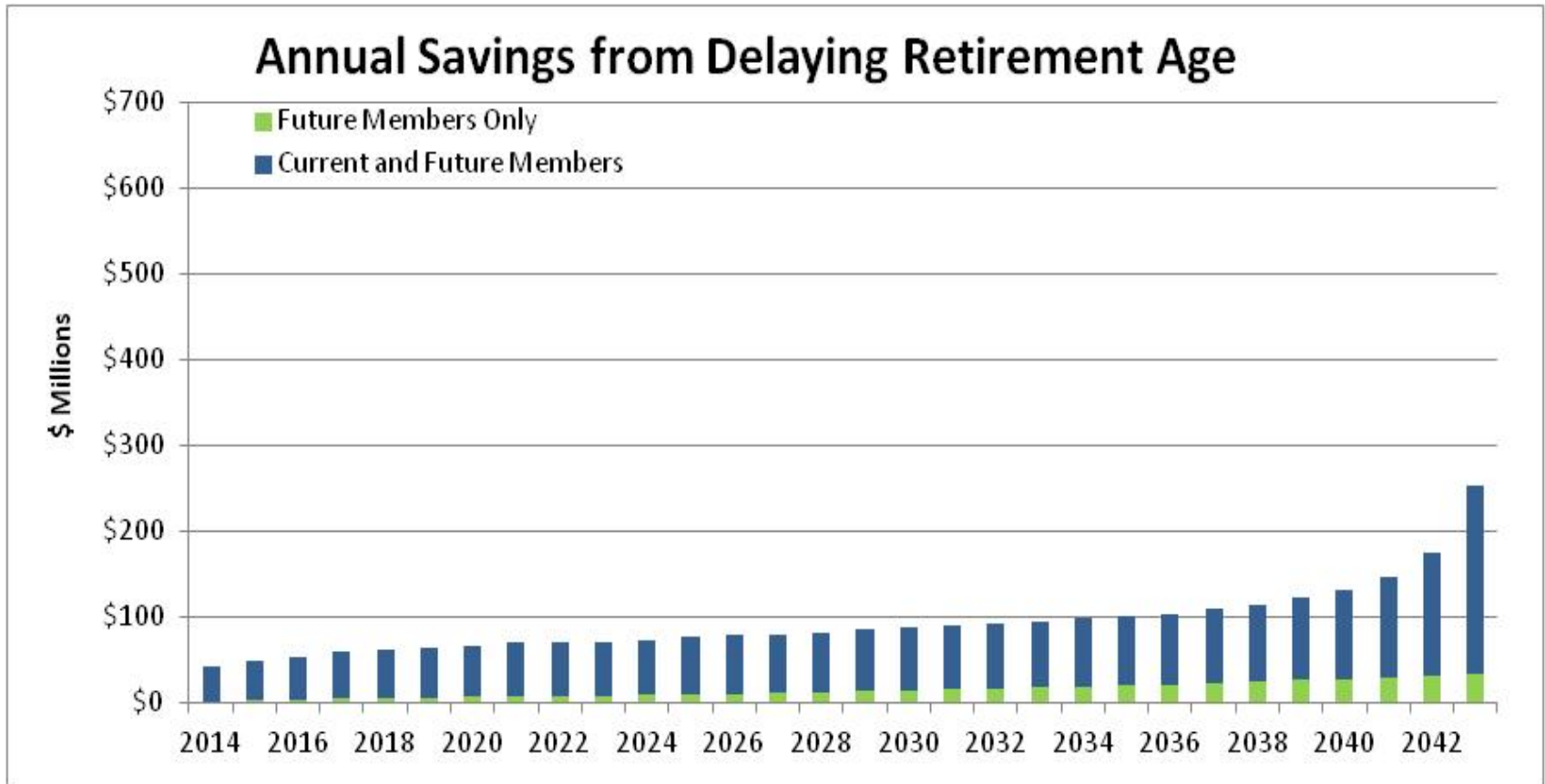


ELIMINATING DROP INTEREST CREDITS



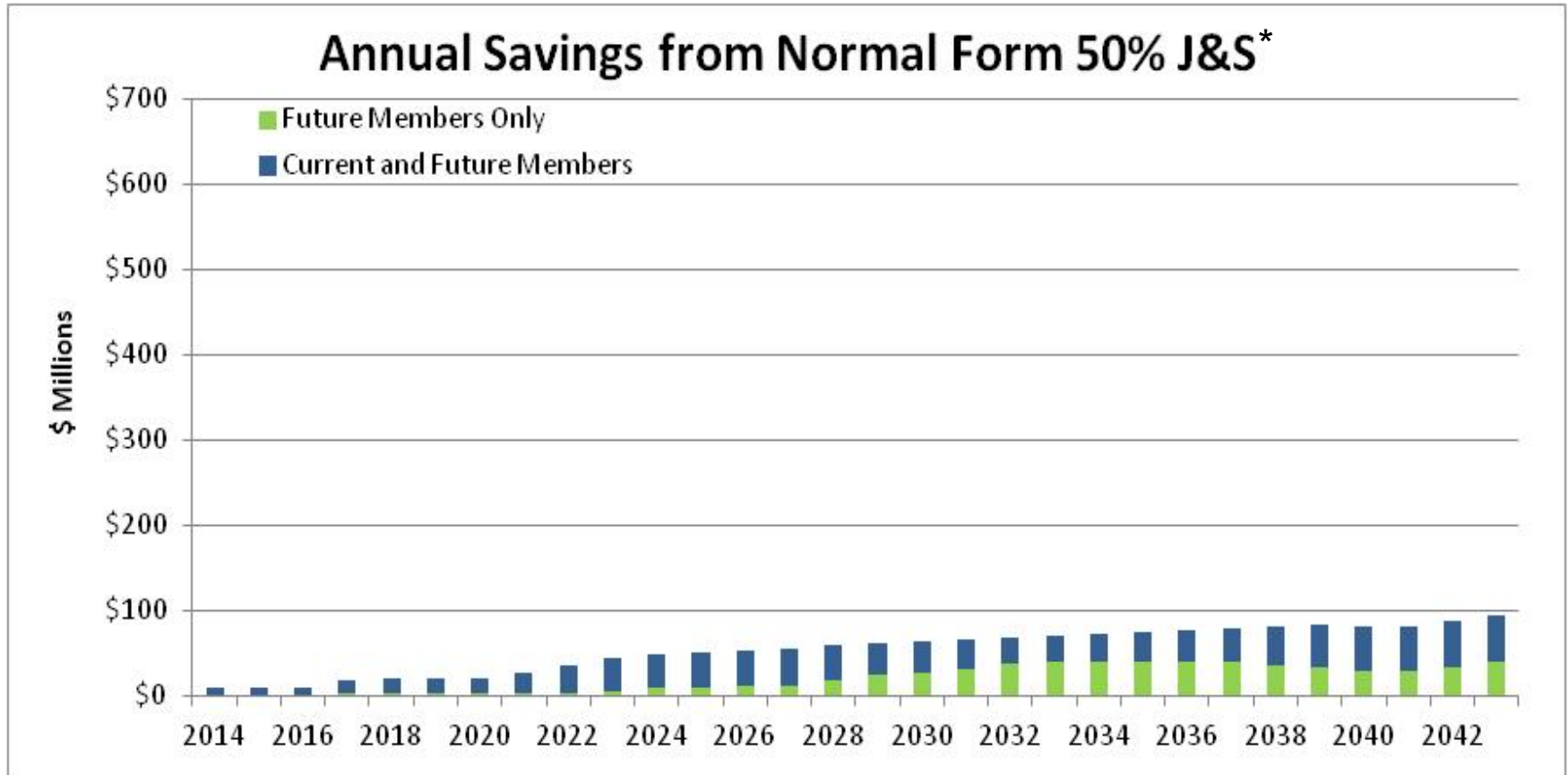


DELAYING RETIREMENT AGE





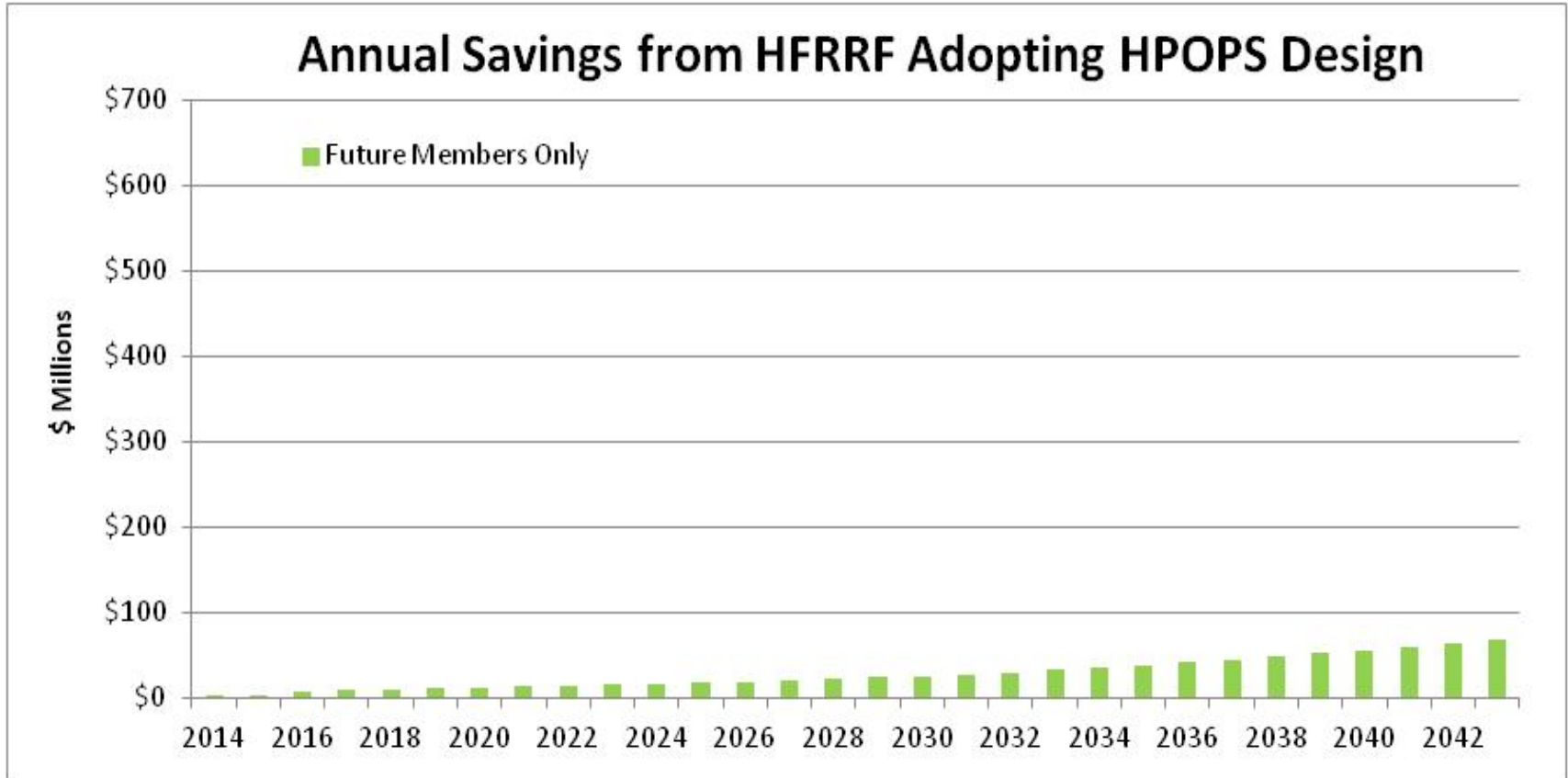
ELIGIBLE SURVIVOR BENEFIT



*Upon a retiree's death, an eligible survivor receives 50% of the retiree's benefit.



HFRRF ADOPTING HPOPS DESIGN





PROJECTED CITY FUNDING OBLIGATIONS FOR BENEFIT CHANGE OPTIONS

- The following slides 23-26 illustrate the projected city contributions and UALs for FY2025 if changes to benefit elements are made for both current and future members
- If multiple changes are made, the results of the single changes illustrated may not be additive



ESTIMATED FUNDING IMPACT OF CHANGES IN BENEFITS FOR BOTH CURRENT AND FUTURE MEMBERS

ALL THREE PLANS COMBINED: Projected for FY2025

	FY2014	No Change	Eliminate Future Automatic COLAs	Reduce Future COLAs to 1%	Freeze DROP	Eliminate DROP Interest	Delay Retirement Age	Change Survivor Benefit to 50%	Adopt HPOPS Plan Design
City Contribution Rate	27.20%	36.10%	17.20%	23.60%	26.90%	31.50%	31.80%	33.20%	35.10%
\$ City Contribution	\$337.90	\$611.40	\$291.20	\$400.20	\$455.30	\$534.30	\$538.60	\$562.00	\$596.00
UAL	\$2,971.00	\$5,107.50	\$1,272.80	\$2,470.50	\$3,154.80	\$4,128.90	\$4,133.70	\$4,535.10	\$5,094.20

Notes:

\$ amounts in millions

See other notes on the plan specific illustrations



ESTIMATED FUNDING IMPACT OF CHANGES IN BENEFITS FOR BOTH CURRENT AND FUTURE MEMBERS

HFRRF: Projected for FY2025

	FY2014	No Change	Eliminate Future Automatic COLAs	Reduce Future COLAs to 1%	Freeze DROP	Eliminate DROP Interest	Delay Retirement Age	Change Survivor Benefit to 50%	Adopt HPOPS Plan Design
City Contribution Rate	23.90%	32.30%	6.50%	14.00%	18.10%	27.30%	29.20%	29.00%	28.30%
\$ City Contribution	\$62.40	\$121.40	\$24.40	\$52.60	\$68.10	\$102.40	\$109.50	\$108.90	\$106.00
UAL	\$489.60	\$727.20	(\$290.10)	(\$4.20)	\$226.10	\$532.90	\$603.80	\$631.70	\$713.90

Notes:

\$ amounts in millions

The minimum contribution rate of 2X the Employee contribution rate not applied

HPOPS plan design applies to future members only

Delayed retirement age is age 55 with 10 years of service

50% survivor benefit for future retirees only



ESTIMATED FUNDING IMPACT OF CHANGES IN BENEFITS FOR BOTH CURRENT AND FUTURE MEMBERS

HPOPS: Projected for FY2025

	FY2014	No Change	Eliminate Future Automatic COLAs	Reduce Future COLAs to 1%	Freeze DROP	Eliminate DROP Interest	Delay Retirement Age	Change Survivor Benefit to 50%	Adopt HPOPS Plan Design
City Contribution Rate	25.80%	35.60%	12.10%	18.10%	20.70%	27.00%	N/A	31.00%	N/A
\$ City Contribution	\$103.00	\$209.40	\$71.30	\$106.70	\$121.90	\$158.80	N/A	\$182.80	N/A
UAL	\$858.70	\$1,841.70	\$242.90	\$630.10	\$802.90	\$1,205.60	N/A	\$1,547.00	N/A

Notes:

\$ amounts in millions

The 80% funding ratio trigger and 15% minimum contribution rate not applied

Future contributions = the ARC if less than the M&C scheduled amount

50% survivor benefit effective for future retirees only



ESTIMATED FUNDING IMPACT OF CHANGES IN BENEFITS FOR BOTH CURRENT AND FUTURE MEMBERS

HMEPS: Projected for FY2025

	FY2014	No Change	Eliminate Future Automatic COLAs	Reduce Future COLAs to 1%	Freeze DROP	Eliminate DROP Interest	Delay Retirement Age	Change Survivor Benefit to 50%	Adopt HPOPS Plan Design
City Contribution Rate	23.40%	32.20%	20.60%	26.80%	30.10%	31.20%	23.20%	30.80%	N/A
\$ City Contribution	\$136.40	\$235.30	\$150.20	\$195.60	\$220.00	\$227.80	\$174.40	\$225.00	N/A
UAL	\$1,622.70	\$2,538.60	\$1,320.00	\$1,844.60	\$2,125.80	\$2,390.40	\$1,688.20	\$2,356.40	N/A

Notes:

\$ amounts in millions

UAL amortization period changed to 30 year fixed when Meet & Confer contribution = ARC

Delayed retirement age is age 65 with 5 years of service

City contributes an additional 6.2% of payroll to Social Security



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Questions?