

**Resolution of the Board of Directors in Support of Pension Reform**

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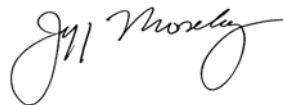
As the primary business advocate for the Houston region, the Greater Houston Partnership (“GHP”) supports the City of Houston in taking all necessary steps to insure that the City of Houston will have actuarially sound pension plans adequately funded out of current tax revenues.

The GHP believes this will result in greater economic stability for both the city and its employees.



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Larry Kellner, Chairman



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Jeff Moseley, President and CEO



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Tony Chase, Secretary

## **BACKGROUND MEMORANDUM**

**DATE:** August 31, 2011

**TO:** Greater Houston Partnership Board of Directors

**FROM:** Charles Swanson, Chair, Business Issues Committee

**SUBJECT:** Resolution of the Board of Directors in Support of Pension Reform

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### **RECOMMENDATION**

As the primary business advocate for the Houston region, the Greater Houston Partnership (“GHP”) supports the City of Houston in taking all necessary steps to insure that the City of Houston will have actuarially sound pension plans adequately funded out of current tax revenues.

The GHP believes this will result in greater economic stability for both the city and its employees.

### **BACKGROUND**

#### **Principles:**

- City of Houston (COH) contributes to the three Pension Systems (Fire, Police and Other Municipal) per state law
- At current benefit levels, COH contributions are projected to increase substantially over the next few years from \$233 million in 2010 to \$505 million in 2020
- Projected unfunded liability is projected to grow to \$5.3 billion by 2020
- COH has been deferring its costs under two of the three pension plans over the last several years by contributing less than the ‘actuarially determined’ rate resulting in:
  - Higher future funding requirements
  - Increase in unfunded liability

#### **Pension Basics:**

- Ultimately, the pension plan must balance projected pension inflows with pension outflows, based on the following balancing scale:

Pension inflows: COH contributions + membership contributions + investment return

= Pension outflows: benefit payments + Pension System expenses

- Each Pension System's actuary determines an actuarially determined funding amount used to help keep the scale in balance assuming other components of the equation remain set
- Contributing less than the actuarially determined amount without reducing pension outflows defers costs, augmenting COH debt and future tax burden and is not actuarially sound

## **PROS AND CONS**

### **Advantages to Employer of Switching**

1. Defined contribution plan shifts the risk of the amount of the retirement benefit from employer to employee.
2. Defined contribution plan fixes the amount of employer contribution. There is no unfunded liability.

### **Disadvantages to Employer of Switching**

1. Defined benefit plans help state and local governments attract and retain qualified employees.
2. Defined benefit plans earn higher investment returns and pay lower investment management fees.
3. Retaining a defined benefit plan is likely to cost state and local governments less over the short term.
4. Defined benefit plans help state and local governments manage their workforce by providing flexible incentives that encourage employees to work longer or retire earlier, depending on the circumstances. Switching to a DC plan would limit this flexibility and make these incentives more expensive for the employer.

### **Advantages to Employee of Switching**

1. Defined contribution plans are portable and provide the employee with greater control.

### **Disadvantages to Employee of Switching**

1. Defined benefit plans reduce the overall cost of providing lifetime retirement benefits by pooling mortality (and other) risks over a relatively large number of participants. Switching to a DC plan requires each individual to bear these risks alone, consequently requiring higher contributions than if the risks were pooled.

2. Defined benefit plans provide secure retirement benefits based on a person's salary and period of service. Switching to a DC plan would likely result in lower and less secure retirement benefits for many long-term governmental employees, including firefighters, police officers, and teachers, who constitute more than half of the state and local government workforce. State and local employees who are without Social Security coverage would be subject to even greater risk.

### **KNOWN OPPOSITION**

Houston Firefighters Relief & Retirement Fund (HFRRF) would prefer that their fund not be subject to open records by COH. HFRRF has continually promoted that they are the only fully-funded COH retirement program.

### **FISCAL IMPACT**

Adoption of this legislative policy position will have no direct fiscal impact on Texas' general revenue.

### **IMPLEMENTATION**

To implement this recommendation, GHP will communicate its support of this resolution.

### **RESOURCES REQUIRED**

This recommendation can be implemented with available GHP staff and within current operating budget resources.

### **ADDITIONAL INFORMATION**

Texas House Committee on Pensions, Investments and Financial Services Hearing March 1, 2011

**Annise D. Parker**, Mayor of Houston, said Houston has 3 separate pension systems: civilian, police and firefighter. It has 42,000 beneficiaries. There is a \$1.146 billion shortfall in the civilian system, \$700 million shortfall in police pension, and a \$221 million shortfall in the firefighter pension, which amounts to approximately \$2 billion. When stock prices decreased, every pension lost considerable funding. COH borrowed money by way of bonds to attempt to solve their underfunding issues. They changed their system in 2009 regarding age requirements, but at year end, due to the continual decline in the market, the situation had not improved and instead COH took on considerable new debt. Mayor Parker mentioned that HMEPS (Houston Municipal Employees Pension System) has worked successfully with COH and the city is working to file pension legislation that will allow the Houston Firefighters Relief & Retirement Fund and COH to "meet and confer." Currently, COH has local control of the police and municipal employee pension plans because of 2004 meet and confer agreements.

Mayor Parker emphasized that all of these plans should be locally controlled (versus handled in Austin) because the Houston taxpayers are funding these pension plans for COH employees.

**Sherry Mose**, Chair, Houston Municipal Employees Pension System, said HMEPS was created in 1943 and has 27,000 participants. They currently manage \$2 billion in assets for their constituents. They are authorized to handle all pensions and pension related matters for COH. They have a great relationship with COH and HOPE, the city employee union.

**Rhonda Smith**, Executive Director, Houston Municipal Employees Pension System, referenced a chart for the majority of her testimony that was given to the committee. Houston's employees, unlike Dallas, do receive contributions from Social Security. The retirement fund is a \$2.1 billion system that provides retirement, disability, and death benefits for its members. The average retiree is 67 years old and earns a modest \$22,000 per year. The fund has earned 9.38 percent rate of return over the long term. The employer's current contribution rate is fixed at \$88.5 million which equates to 15.4 percent.

**Todd E. Clark**, Chairman, Houston Firefighters Relief & Retirement Fund (HFRRF), said they have 10 members on their board: 2 citizens, 5 active firefighters, 1 retired firefighter, 1 Mayor representative and the Treasurer or a representative from the Treasurer's office. HFRRF has 6,509 members; 3,948 of which are active members; 2,561 are retired or survivors. As of the 2010 evaluation report, HFRRF is 93.4 percent funded. The firefighters in COH do not pay Social Security. Over the last 10 years, the pension fund has received 69 percent of its income from investments. You have to have 20 years of service to enter the DROP (Deferred Retirement Option Plan) program, which draws an interest rate at a minimum of 5 percent and a maximum of 10 percent.

**Christopher E. Gonzales**, Executive Director, Houston Firefighters Relief & Retirement Fund, said the return rate on the investment plan is 16.3 percent. The assumed rate of return is 8.5 percent. Regardless of the downturn in 2009, the 7-year annualized return as of December 31, 2010 is 9.2 percent, which is better than expected. Eighty-two percent of the time over the last 22 years, they have met or exceeded the 8.5 percent expected return on a 10-year rolling basis. HFRRF began in 1937 and remains controlled in Austin as a manner to protect the fund from any changes in benefit levels.

**John E. Lawson**, Executive Director, Houston Police Officers' Pension System, said the police department pension system allows for pension benefits for surviving spouses. There are 8,400 individuals depending on the Houston pension system. Houston police officers are not eligible for the Social Security system. The officers hired after 2004 have different benefits than those hired prior. There is an 8.5 percent return expectedness in this system, and it is currently 14.5 percent. The long-term rate of return for this plan is 10.5 percent.

