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The heart of Houston's pension problem is debt, not benefits

Push for 401(k)-style plans doesn't fix years of underfunding, unmet goals

By Mike Morris

Houston's pension reform legislation has stalled in Austin as some conservatives argue the only permanent fix for the city's crisis is to make future employees shoulder the risk of securing their own retirement benefits.

This push for 401(k)-style "defined contribution" plans, however, would do nothing to solve the primary source of Houston's spiraling pension costs: the $8.2 billion in debt Houston has accumulated after years of underfunding its pensions and the pension funds falling short of their investment goals.

Even scrapping new workers' pensions entirely, experts note, would not touch this mountain of debt, which Mayor Sylvester Turner's reform plan would reduce by $2.8 billion with cuts to police officers', firefighters' and municipal workers' benefits.

Turner's plan - which could reach a vote in both legislative chambers as early as this week - also would lower the funds' investment targets, prevent the city from continuing to short its payments, cap the city's future costs and split a $1 billion infusion of bond proceeds between two of the pension funds.

The mayor's plan preserves the city's traditional pensions rather than forcing new employees into a less generous system, which has drawn conservative pushback.

Sen. Paul Bettencourt, R-Houston, wants to let voters give defined-contribution plans - DC for short - to all future city workers; a local group of activists has submitted petitions to City Hall to place such an item on the November ballot.

Bettencourt acknowledged moving to defined-contribution plans would not lower the city's debt burden, but he said that does not make it a less worthy discussion.

"We should have done it a decade ago," he said. "See, the problem is that if you don't have the discussion, then it's always, 'Oh it's next decade that we'll do it.'"

Other conservatives have abandoned the push for defined contribution and now want the bill to push new hires into a typically less generous traditional pension model - called a "cash balance" plan - should the financial health of any of the pensions erode to a specified point.

To city Finance Director Kelly Dowe, much of this debate misses the point.

After Houston's pension costs spiked in the early 2000s, the police and municipal pensions cut benefits and let the city pay less than the amount needed to fully fund benefits each year.

That helped create billions of dollars of debt and means more than three-quarters of the city's next payment to the police and municipal pension funds would go to pay off that debt.

It also means that the remaining portion of the city's payments to those plans - the dollars that go to cover workers' benefits - is in line with or lower than national averages, according to data from the Center for Retirement Research at Boston College.

Debt before reform

Houston's firefighters, by contrast, never agreed to cut benefits or accept smaller payments. So Turner's plan takes a larger share of its costs savings from their benefits than from the already-reformed police and municipal plans.

Moving new police officers into a 401(k)-style plan would save taxpayers money only if the city decided to put much less than the national average toward their retirement, Dowe said, adding that it would become even more difficult to recruit cadets then.

"If you're not able to cut that contribution, you're not saving anything; you're just taking risk off the table - which is a noble aim in and of itself, but it doesn't produce cost savings," Dowe said. "I don't think the majority of people understand that the vast majority of the payment is debt today."

State Sen. Joan Huffman, the Houston Republican who is carrying the reform bill in the upper chamber, echoed that point.

"Any new system, whether it be DC or whether it be cash balance, would not address the legacy debt," she said. "We have to address the legacy debt to move forward with reform."

'Compounding the problem'

Arnold Foundation pension expert Josh McGee, who also chairs the state Pension Review Board, said the decision to move to a 401(k)-style plan is motivated by a desire to achieve better transparency and cost certainty, not to save money.

"DC (a defined-contribution plan) would do nothing to address the legacy liability, but it's not meant to address that," he said. "What it does is it ensures the city could not accumulate large and costly pension debt in the future on those new workers, compounding the problem."

Some pension officials say a switch to defined contribution, far from saving the city money, would drive up costs.

An actuarial analysis commissioned by John Lawson, the executive director of the police pension, showed that closing the city's traditional pension system and placing new hires into a 401(k)-style plan would require $11.7 billion in contributions from the city over the next 50 years, about $875 million more than if Turner's plan was enacted as-is.

The key reason for that, Lawson said, is that the fund would be forced to adopt a more conservative investment approach as fewer workers contributed over time and more money flowed out to pay benefits. Lower investment returns from any of the pension funds mean the city would need to contribute more money to make up the difference.

By Lawson's calculations, not being more conservative could lead the fund to run out of money in 2058 - when it still has 2,900 beneficiaries to support - even if it averaged a 6.8 percent return over the preceding four decades.

The police fund has averaged 5.4 percent a year over the last decade.