Presentation to the State Pension Review Board of Texas

Sustainable City of Houston Pensions

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Overview

• Background
  – Mayor’s commitment: Fair, affordable and sustainable pensions

• Houston’s plan
  – Be clear about what the City owes
  – Reduce liability
  – Manage costs going forward

• Cost management: The corridor

• Next steps
Background

- Pension reform a priority for Mayor Turner
- Three objectives for now and in the future
  - Reduce costs
  - Reduce unfunded liability
  - Achieve a solution that removes pension issues from the table
- Employees, retirees and taxpayers deserve a pension system that is fair, affordable and sustainable
- Shared sacrifice is required to meet the objectives
- Nearly a year of working closely with pension system representatives
Houston’s Plan: What is owed?

• First step: Get a clearer look at what we owe

• Requires more accurate calculation of City’s net pension liability
  – Reduce anticipated rate of return (i.e., discount rate) for all three systems to 7 percent
  – Recognize all investment and other actuarial gains and losses as of June 30, 2016

• Impact: Increase City’s pension liability from $5.6 billion to $8.1 billion
Houston’s Plan: Reduce liability

• Second step: Reduce the City’s pension liability
  – Benefit adjustments in all three systems to reduce future costs: liability reduction of $2.54 billion
  – City addresses past underfunding with issuance of $1 billion in POBs
    • HMEPS ($250 million) and HPOPS ($750 million)
  – City required to make full annual contributions to each system: no more long-term underfunding

• Impact: Total immediate reduction in net pension liability of $3.54 billion
Houston’s Plan: Reduce liability

Sources: City of Houston January 2017 actuarial reports for HMEPS and HPOPS; COH-HFRRF term sheet.
Houston’s Plan: Manage costs

• Third step: Better management of pension costs and liability in the future
  – Closed 30-year amortization sets clear schedule and hard date for payoff: no more “kicking the can”
  – Corridor sets City contribution boundaries that trigger pension system changes if breached
Houston’s Plan: The corridor

Overview of Risk Sharing
The Corridor is a cost management mechanism designed to ensure plan sustainability

Maximum Contribution Rate

Scenario 1

Scenario 2

Scenario 3

Scenario 4

Minimum Contribution Rate

Declining Pension Costs

Scenario 1: Inside Corridor – between Midpoint and Minimum
- City Contribution Rate is in between Minimum and Midpoint
- If system <90% funded, City contribution remains at minimum
- Otherwise, City contributes at rate needed to fully fund the system

Scenario 2: Outside Corridor – Below Minimum
- City Contribution Rate is below Minimum
- Bring City Contribution Rate back to Minimum by making system adjustments in order proscribed by law (e.g., recognize market losses if doing so increases contribution rate)

Rising Pension Costs

Scenario 3: Inside Corridor – between Midpoint and Maximum
- City Contribution Rate is in between the Midpoint and the Maximum
- City contributes at higher rate needed to fully fund the system

Scenario 4: Outside Corridor – above Midpoint
- City Contribution Rate is above the Maximum
- Move City contribution rate back within corridor with system adjustments (e.g., use prior overfunding)
- May also require benefit changes to bring contribution rate to Midpoint over a three year period

Corridor Midpoint = proposed benefits package estimated cost
Next steps

• Rep. Flynn has submitted agreed-upon legislative language and term sheets to Texas Legislative Council
• Coordinating with Senate sponsor Sen. Huffman
• Bill is to be presented as committee substitute for HB 43