Center for State & Local Government Excellence

Houston, Texas, Municipal Employees Pension System

Plan Summary	2001–2004 Plan Provisions	After 2004 Plan Changes Enacted	After Fourth Amendment Adopted in 2007
Plan Type	Defined Benefit	Defined Benefit	Defined Benefit
Contribution Rates	**Group A:** Employee contribution: 4% of salary. **Group B:** No employee contribution required.	**Group A:** Employee contribution: 5% of salary. **Group B:** No employee contribution required.	**Group D (all employees hired after 1/1/2008):** No employee contribution.
Funding Formula	**Group A:** multiplier of 4.25% for more than 20 years of service with a 4% cost of living adjustment (COLA). **Group B:** multiplier of 2.5% for more than 20 years of service with a 3.5% COLA.	**Group A:** multiplier of 3.25% for more than 20 years of service with a 3% COLA for employees hired before 1/1/2005 and a 2% COLA for employees hired after 1/1/2005.	**Group D:** multiplier of 1.8% for the first 25 years of service and 1% for each succeeding year. No COLA.
Membership	12,345 active, 5,613 terminated vested, and 8,717 retired members as of July 1, 2011[1]		

Background

Due to a growing unfunded liability resulting from benefit increases in 2001 as well as investment losses, the city and the Houston Municipal Employee Pension System (HMEPS) negotiated a series of reforms to the municipal pension plan in 2004.

Until 2000, HMEPS was sufficiently funded on an actuarially determined basis with annual city contributions of approximately 10 percent of payroll. The benefit increases in 2001 had been expected to raise future city contributions to 15 percent of payroll. However, a 2003 study determined that the enhanced benefits required contributions of approximately 50 percent of payroll to fund the plan.

Newly elected Mayor Bill White made HMEPS reform a priority at the beginning of his administration, but a state constitutional amendment prohibited changes to benefits for vested municipal employees.

In September 2003, Texas voters approved an amendment to the state constitution that was designed to protect the accrued retirement benefits of vested members and retirees in the public pension system. The amendment provided a one-time opt-out opportunity that allowed political subdivisions to hold an election to exclude themselves from its provisions. Mayor White called for an election and, in May 2004, city voters approved the measure for the city to exercise the opt-out provision.

Following the referendum, city administrators and the HMEPS board negotiated modifications to the contract:

- Increased the employee contribution rate for Group A from four percent to five percent of salary and reduced the multiplier from 3.25 in the first 10 years of service and 3.5 in the second (years 10-20) to 2.5 percent for the first 20 years of service, and from 4.25 percent to 3.25 percent for more than 20 years of service.
- Disallowed the conversion of Group B service time to Group A.
- Reduced the COLA from four percent to three percent for retirees hired before January 1, 2005, and from four percent to two percent for retirees hired on or after January 1, 2005.
- Changed retirement eligibility age from the "Rule of 70" (age plus years of service) to the "Rule of 75."
- Transferred a $300 million note from the city to HMEPS.

The agreement also specified a ceiling for city contributions and a transfer of assets to provide funding for the subsequent three years.

These changes reduced the city contribution rate to 24 percent of payroll, which was still higher than the anticipated 15 percent so the agreement was subsequently modified again. Two of the amendments had significant impacts:

- The second amendment, which was adopted in April 2005, altered the composition of the HMEPS board again to provide for more diverse financial expertise. As a result, the elected city controller and two representatives selected by the city council were given appointed seats on the board.
- The fourth amendment, which was adopted in June 2007, created a new HMEPS tier—Group D—which covered all employees hired on or after July 1, 2008. Group D features a retirement age of 62 (with early retirement available at age 55 with reduced benefits) and a multiplier of 1.8 percent for the first 25 years of service and 1 percent for each succeeding year. Group D participants do not contribute to the system, nor do they receive a COLA upon retirement. Additionally, they are ineligible to participate in the Deferred Retirement Option Plan (DROP) that is available to Groups A and B.[2]

The amendment also established new four-year ceilings for city contributions.

In June 2011, the city and HMEPS reached an agreement on a funding extension to provide structured contributions from the city. Under this agreement, the city will contribute $98.5 million to HMEPS in FY 2012. For every subsequent year, the city will contribute either the previous year's rate plus two percent of payroll or the previous year's contribution amount plus $10 million, whichever is greater.[3] This provision will remain in effect until the actuarially determined contribution rate is met, at which time that rate becomes the effective contribution rate.

Reform Results

In 2012, the city will pay $98.5 million—approximately 74 percent of the actuarially required contribution (ARC)—as agreed to in the 2007 amendment. According to projections by the plan actuary, the city is expected to pay its actuarially determined rate by 2015.[5]

With the creation of Group D, Houston offered a defined benefit plan that could be coupled with a voluntary supplemental employee contribution account administered through the existing 457 defined contribution plan. According to Chief Pension Officer Craig Mason, the city faces challenges in encouraging employees to contribute to their supplemental 457 account since the two plans are administered separately and there is a lack of coordination. As such, they are not seeing increased participation or contributions to the 457 plan.

Future Plans

No further plan changes are currently under consideration. However, the 8.5 percent investment rate of return assumption is the subject of continuing discussion, although it is supported by the plan's actuary.

Funding Progress (for dollar values, in millions)[4]

Year	Actuarial Value of Assets	Actuarial Accrued Liability	UAAL	Funded Ratio	Covered Payroll
2011	2,328.8	3,790.3	1,461.5	61%	544.7
2010	2,273.1	3,632.5	1,359.3	63%	550.7
2009	2,284.4	3,451.4	1,167.0	66%	539.0
2008	2,310.4	3,296.3	986.0	70%	483.8
2007	2,193.7	3,128.7	935.0	70%	448.9

Endnotes

1 Conversation with Craig Mason, June 8, 2012.

2 http://www.hmeps.org/benefits/drop_overview.pdf

3 Amended and Restated Meet and Confer Agreement Between the Houston Municipal Employees Pension System and the City of Houston (July 1, 2011)

4 Houston Municipal Employees Pension System Comprehensive Annual Financial Report for the Year Ended June 30, 2011

5 Communication with Craig Mason, chief pension officer, May 21, 2012