LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 78TH LEGISLATIVE REGULAR SESSION

April 28, 2003

TO: Honorable Chris Harris, Chair, Senate Committee on Administration

FROM: John Keel, Director, Legislative Budget Board

IN RE: **HB601** by Thompson (Relating to the administration of a retirement system for officers and employees of certain municipalities.), **As Engrossed**

No fiscal implication to the State is anticipated.

Local Government Impact

The bill would allow the Houston Municipal Employee System to increase benefits. The fund currently has a significant unfunded liability, as described in the methodology below. If benefits were increased, this amount could increase substantially. The bill also has a provision which allows the city and the pension board to enter into a written agreement regarding pension issues and benefits, which would be enforceable against and binding on the city and the pension plan members. If the bill passes and the city enters into an agreement guaranteeing current benefit provisions, this liability could not be reduced through future plan design changes.

If assumptions are met, the liability is expected to increase at an annual rate of 8.5 percent. It will grow even further if the plan is not able to earn a rate of return on its assets equal to the actuarial assumption of 8.5 percent. The liability will decrease if the pension plan is able to consistently earn a rate of return in excess of its actuarial assumption of 8.5 percent. Other factors affecting the liability include other experience such as payroll growth or the withdrawal rate, though these factors generally have significantly less impact on unfunded liability than the rate of return.

If the city were to pay off the unfunded liability in a level dollar amount from 2004 through 2022 through the form of additional payroll contributions, the additional payroll costs would be approximately $100 million annually. The plan's statute requires any unfunded liabilities to be funded by 2022. Typically, a pension plan's unfunded liability is paid off based on an actuarially smoothed liability and via a level percent of contributions which would result in a different contribution pattern, though the present value of expected payments would be the same.

The city is currently making a 10 percent payroll contribution for normal costs, but no contribution for unfunded liabilities. At the time of the last benefit increase (two years ago), the actuarially required contribution was estimated to be 17 percent. Paying this increase, and adding contributions to amortize the unfunded liability as deferred market losses are realized, may make it challenging to afford any additional benefits authorized under the provisions of the bill that allow benefit increases.

Methodology

The unfunded liability of the plan is estimated to be $1.0 billion as of December 31, 2002. This is based on the market value of plan assets as of December 31, 2002, estimated by the plan to be $1,184 million. The difference between the market value of assets and the Actuarial Accrued Liability (AAL) is the market-based unfunded liability the city would incur. The AAL is estimated to be $2.2 billion as of December 31, 2002. This is calculated as the AAL reported in the July 1, 2001 valuation, increased at a rate of 8.5 percent annually, with an offset for the difference between contributions and benefit payments.

If the AAL estimate was based on the figures used in the actuarial analysis for the benefit increase implemented in House Bill 1573, Seventy-seventh Legislature, 2001, it would be approximately $100 million less than the estimate used here, and the corresponding unfunded liability would be $100 million less. Presumably, the 2001 valuation more accurately reflects the plan's experience and liabilities than the estimate used for House Bill 1573.

An actuarial valuation based on December 31, 2002 might show a different AAL based on experience other than investment experience, however the difference would generally be expected to be relatively small. No actuarial valuation for the plan was performed for 2002.

Source Agencies:
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