LEGISLATIVE BUDGET BOARD
Austin, Texas

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TO: Honorable Allan Ritter, Chair, House Committee on Pensions & Investments

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 Introduced**

No fiscal implication to the State is anticipated.

Local Government Impact

The provisions of the bill would allow the city of Houston to enter into a contract with the Houston Municipal Employees Pension System board, and the contract terms would include a provision prohibiting the reduction of any earned or accrued benefit. If the city did not enter into a contract, the plan's unfunded liability would not differ from the amount described in the methodology below, however the plan would have the option of reducing benefits to reduce liabilities. 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. Additional liabilities would be incurred if benefits were increased under the provision of the bill which allows the board and city to agree to benefit improvements without statutory changes. 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.

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 liability the city would incur with no funds to back it up. 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:

LBB Staff: JK, SD, JO, RR, JB, WM