An Open Letter to City of Houston Employees Regarding Your Pension Systems

In a few weeks, voters in the City of Houston will choose a new mayor. That mayor will be faced with many challenges, but none of greater consequence than dealing with the underfunding of the city's three pension systems for municipal employees, fire and police.

Let me start by making one point emphatically clear: **I do not support changing the benefits that you as city employees and retirees have already earned. In Texas, a deal is a deal, and if I am elected mayor the city will honor the promises it has already made to you.** After all, you have given the city your years of service based on those promises.

If we do nothing about pensions, however, we are setting up a very real and deepening financial crisis that will pit future generations of taxpayers and public employees against each other as the bills come due for the promised benefits — and there is no money to pay them. A number of other cities and states are going through this painful process now. We simply cannot allow that to happen to Houston.

Virtually everyone agrees that the current pension system is not sustainable. All seven of the major candidates for mayor, including the candidate endorsed by the employee groups, have stated that changes must be made to the current system. In addition, researchers at Rice University and the University of Houston have both reached the conclusion that the current system is unsustainable in the long run. So have each of the last three chief financial officers and Controllers for the city. The Houston Chronicle and the Houston Business Journal have both also called for reform. The Greater Houston Partnership poured tremendous time and energy into studying the problem, and issued a white paper this summer in which they declared: "What we cannot do is wait."

In fact, there is no one without a financial stake in the current plans that believes the current system is viable in the long run.

And that brings me to a very important point. Last year, your pension plans spent nearly $60 million on administrative and investment expenses. That is up from about $50 million the previous year — a 20% increase in one year. There is an entire cottage industry of Wall Street bankers, lawyers, accountants and actuaries that make their living off of your pension plans. They know that the reform of these plans will disrupt their income. After all, the city was short about $110 million in funding your plans last year. Those administrative fees would have made up more than half of that deficit.

In contrast, I have no financial stake in the outcome of the pension question.

Some of the leaders of the employee groups have characterized my views as a Wisconsin-style, union-bashing, anti-public worker initiative. (I expect their name-calling to escalate in the final stages of the campaign.) Nothing could be farther from the truth. In fact, reforming these systems is the only chance you have of assuring that you will receive the benefits you have been promised.

Instead of rampant rumors, let's have some straight talk about the financial condition of each of the plans. The three plans are actually quite different, both in the amounts of the benefits and the degree to which the city has put aside money to pay those benefits.

- Ironically, the plan that is in the worst financial condition, the HMPES, also pays the most modest benefits. According to the actuaries, hired by the HMPES trustees, the city and the HMPES members should have set aside about $4.3 billion to pay for the bene-

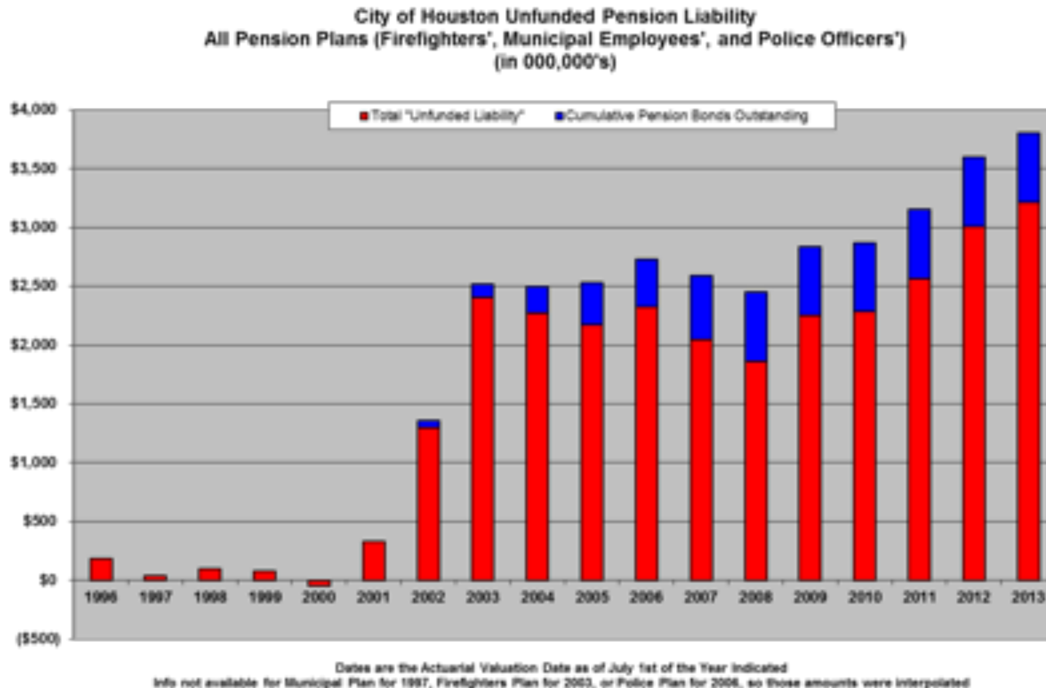
fits the members had earned through June 2014. However, as of June 2014 the plan had assets of only about $2.5 billion in the pension fund to pay these benefits. In other words, the city and the HMPES members have only put up a little more than half of what was necessary to pay the benefits that have already been earned. Since the city is obligated to see that these benefits are paid without any further contribution from the members, the city has in effect “borrowed” $1.8 billion from the HMPES members.

- The police officers’ plan is in somewhat better shape. Again, according to the actuaries hired by HPOPS trustees, the city and the HPOPS members should have set aside about $5.4 billion to pay for the benefits through last year — but the plan had about $1 billion less than that as of that date.

- The plan for the HFD employees is in the best financial shape. As of the date of this letter, the HFRTS has still not issued a report for 2014 (more on that later). The 2013 report showed that the fund was about $500 million short, and that it had about 86% of the money it needed to pay the benefits that had been earned.

So, according to the most recent reports available, the city is about $4 billion short of having set enough money aside to pay the benefits that have been promised to its employees. That is not the end of world, but it is something that should concern every city employee and retiree.

You will hear frequently from some of your leadership that this shortfall is the result of the city not making the required contributions “for decades.” This is not true. As the chart below shows, as late as 2000, the pension trust funds had enough money in them to pay all of the promised benefits.



However, from 1999-2002, the city and the State of Texas agreed to some very large increases in the benefits in all three plans. These increases applied retroactively. Of course, not enough money had previously been set aside to pay for these increases to the benefits, so the plans

instantly became underfunded by the cost of those new, higher benefits. In just three years, the plans went from being fully funded to $2.5 billion in the hole.

Once a plan becomes underfunded, as these did in 2000-2003, it becomes very difficult to catch up. At that point, the employer and employees must contribute more every year: not only what is necessary to pay for benefits earned that year, but also an additional amount to try and make up the shortfall. The city has failed to do this since 2003, so it has gradually fallen deeper into debt to the pension plans, such that it now owes something closer to $4 billion.

There are many ways to address this problem. Private industry did so 20-30 years ago, mostly by adopting strategies that transitioned from defined-benefit plans to defined-contribution or 401K-like plans. **This is the path I favor to resolve our pension crisis — placing new city employees, hired after a date in the future, in defined-contribution plans.**

Why? Because defined-benefit plans allow politicians to promise public employees a retirement benefit without going through the painful process of asking taxpayers to pay for those benefits. Instead, the liability for the promised benefits is kicked down the road to our children and our grandchildren.

In defined-contribution plans, however, the full contribution must be funded each year.

There are other ways to address the problem, but continuing on the current path is not an option. It will result in a financial disaster for everyone — massive tax increases like we are seeing in Chicago, drastically reduced benefits for current retirees, and more.

Fortunately, our situation is not that as dire as many other cities ... yet. But if we continue to ignore this problem, it will only get worse.

If you are a city employee or retired from the city, I would encourage you to read the actuary report for your plan. The municipal employee plan can be found [here], the police [here] and the fire department plan [here]. The most recent reports for the municipal employee and police plan are as of June 2014.

The fire department plan decided not to issue a report this year because their results were so poor, so the most recent report publicly available is from June 2013. (It is a clear red flag when your board is not issuing reports on an annual basis.)

These are extremely complicated to read, especially for those who do not have a financial background. However, the most important number is the Unfunded Accrued Actuarial Liability (UAAL). This is an estimate by the actuaries of the amount that your employer would have to put into the plan to pay for the benefits that have been earned so far. I would also encourage you to look for the page entitled "Outlook" which shows a 10- or 20-year projection for each plan. In each case you will see that the plans' financial condition continues to decline as the city goes farther into debt to each one.

There are very powerful interests that do not want you know how serious this situation is. As a result, these interests attempt to discredit anyone who warns you about the problem. But while those who make their income off your pension plan can cast all the aspersions they want about how that this is some effort to beat up on public employees, it does not square with the facts.

The numbers do not lie.

It would be profoundly irresponsible for our generation to leave this problem for our children and grandchildren. Facing up to and dealing with it, honestly and fairly, would be a great legacy to leave them, whether they will be future public employees **or** future taxpayers. We can do this. We must do this.

If you help me become the next mayor, I will not let you down.

If you have any questions or need any help trying to analyze the financial condition of your pension plan, please do not hesitate to contact me at info@billkingforhouston.com.

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Houston, Texas
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