City of Houston Annual Pension Update 2020

Three Years After Pension Reform

Nearly three years following the historic pension reforms the data reflects the significant impact on the City's finances that the reforms promised to produce. As a direct result of the reforms, our net pension liability continues to be half what it was prior to reforms, funded ratios of the plans are up and our net position has improved. The rating agencies have taken notice of these improvements. Additionally, the City continues to make the full actuarially required payments at a stable rate of pay resulting in budgetary stability.

Effect on Net Pension Liability

Prior to reforms, the City estimated the Net Pension Liability (NPL) of the systems was approximately $8.21B and estimated that the reforms would reduce that liability by $2.9B without giving effect to the Pension Obligation Bonds (POB), which would lower it by an additional $1B, for a total reduction of $3.9B. Including the reduction in liability due to POB, the NPL was cut in half to $4.03B in fiscal year 2018. Based on the latest data as provided by the systems, the NPL is $4.07B. This slight expected increase is due to payroll growth of employees of three systems.

Net Pension Liability				
($ billions)	Municipal	Police	Fire	Total
Fiscal Year 2018 Liability Without Reform	3.18	3.44	1.59	8.21
Fiscal Year 2018 Liability Post-Reform	2.12	1.26	0.64	4.03
Fiscal Year 2019	2.14	1.25	0.69	4.07
Increase/(Decrease) (2019 compared to 2018 Post-reform)	0.01	(0.01)	0.05	0.04

Source: City of Houston Comprehensive Annual Financial Report.

Funded Ratio

Another indicator of plan health is the funded ratio, which compares the assets to the total liabilities of the plan. This indicator has improved for the three consecutive fiscal years since the reforms were enacted for Municipal and Police plans while it has remained relatively stable for the Fire Plan.

Funded Ratio			
Fiscal Year	Municipal	Police	Fire
2016	48%	62%	81%
2017	52%	68%	86%
2018	58%	81%	87%
2019	59%	82%	86%

Source: City of Houston Comprehensive Annual Financial Report

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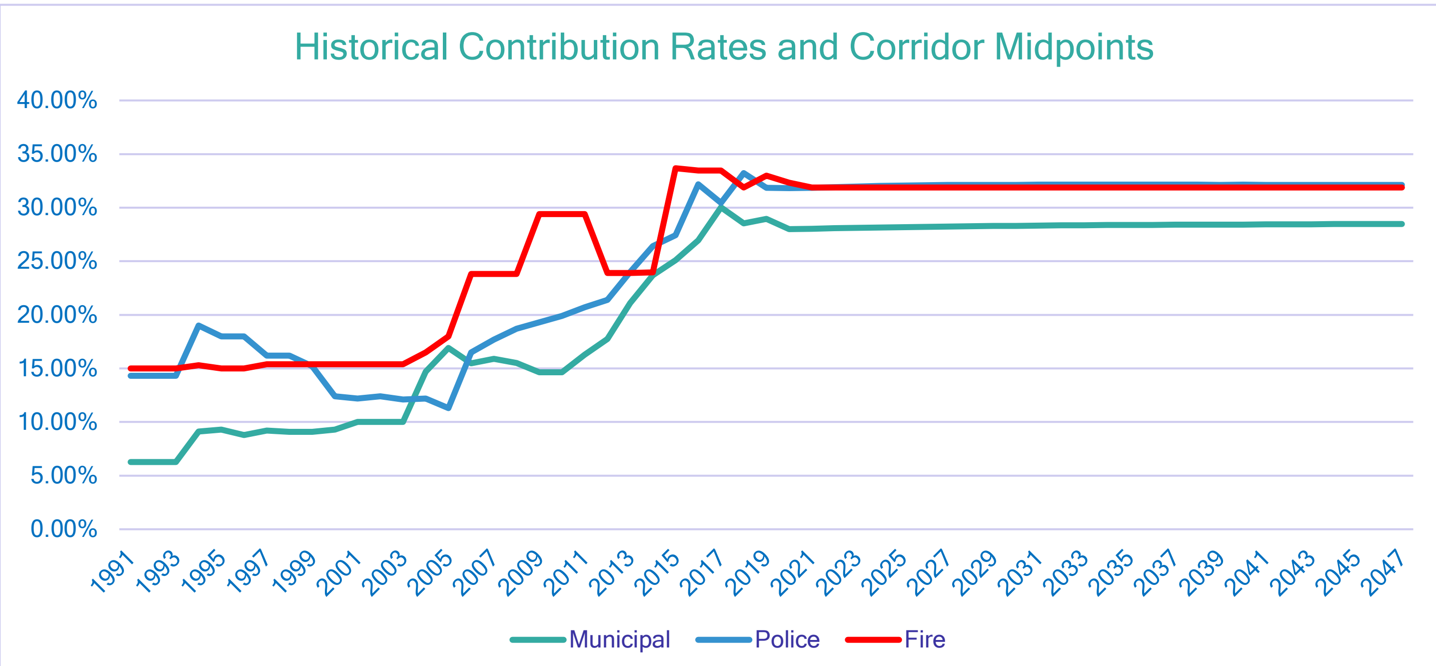
Predictable contributions now and into the future

The Risk Sharing Valuation Study process sets the "corridor" that establishes the upper and lower bounds for the City's contribution rate for a 30-year period, decreasing volatility and adding predictability to the City's payments.



Sources: Pension System Actuarial Valuation Reports, City of Houston Comprehensive Annual Financial Reports, and Pension System Risk Sharing Valuation Studies.

Budgeting to fully-fund the systems

In prior years, only the actuarially required contribution was made for the fire system, with the municipal and police systems funded at lower levels due to budgetary constraints. Following the reforms which began with FY2018, the City is now making the full actuarially required contributions for all three pension systems.

Fiscal	Municipal Contributions		Police Contributions		Fire Contributions	
Year	Actuarial	Actual	Actuarial	Actual	Actuarial	Actual
2014	26.10%	21.44%	34.50%	26.59%	31.10%	23.97%
2015	27.50%	24.98%	36.01%	27.42%	33.20%	33.68%
2016	27.38%	26.96%	38.18%	32.19%	N/A	33.45%
2017	31.81%	30.03%	39.59%	30.44%	30.80%	33.47%
2018	27.84%	28.06%	31.77%	33.22%	31.89%	31.88%
2019	28.91%	28.70%	31.85%	32.00%	32.99%	33.00%
2020	29.29%	TBD	31.84%	TBD	32.34%	TBD

Sources: Pension System Actuarial Valuation Reports, City of Houston Comprehensive Annual Financial Reports, and Pension System Risk Sharing Valuation Studies.

Prior to reforms the City saw double digit year-over-year growth in contributions made to the systems. Since reform, the increase is modest, due to the relatively flat contribution rates year to year, with the growth in dollars being driven by the modest growth in payroll.

Fiscal Year	Municipal City Contribution ($ millions)	Police City Contribution ($ millions)	Fire City Contribution ($ millions)	Total City Contribution ($ millions)	YOY Increase (Percentage%)
2014	128.3	103.4	64.3	296.0	14%
2015	145.0	113.7	92.6	351.3	19%
2016	160.0	137.4	94.3	391.7	12%
2017	182.6	133.8	93.7	410.1	5%
2018	171.6	137.1	83.0	391.7	(4%)
2019	176.3	142.4	89.9	408.6	4%
2020(budgeted)	195.1	149.2	83.7	428.0	5%

Source: Comprehensive Annual Financial Reports. Note, the FY2018 contributions do not include pension obligation bond proceeds in the amount of $750M for police and $250M for municipal.

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Impact on net position

The City of Houston's Comprehensive Annual Financial Report for the period ending June 30, 2017, released in December 2017, showed a major improvement in the City's net position–going from $95M in the red to $1.855B in the black–a swing of $1.9B primarily due to pension reform.

The City of Houston's Comprehensive Annual Financial Report for the period ending June 30, 2019, released in December 2019, showed a substantial deterioration in the City's net position–going to just $972M–a reduction $883M over two years primarily due to a GASB change related to Other Post-Employment Benefits (OPEB) which was effective beginning in 2018.

Rating agencies

Credit rating agencies have taken notice of these historic reforms. In November 2017 following the passage of the pension obligation bonds, Moody's raised the City's outlook to stable from negative (Aa3) and in January S&P followed suit (AA). Since that time, in November 2018 Proposition B, was passed by voters, prompting Fitch to lower the City's outlook to negative, even though the courts have ruled that Proposition B is preempted in its entirety and unconstitutional.

Overall Economy

Beginning in February 2020, the United States, along with the rest of the world, has started seeing a spike in the Novel Coronavirus (COVID-19) cases. In March, we saw near unprecedented volatility in the financial market on a daily basis with loss in the markets of approximately 27%. Recently, there has been some recovery in the markets. We are closely monitoring the on-going situation daily, and the three pension plans may not reach the annual set investment rate of return of 7%. An important aspect of the pension reform is the smoothing of investment gains/losses over a five-year period. This will have the result of smoothing any spikes in the City's contribution rate. Even then, there will not be an impact to the City's contribution rates until FY2022.

Note:

This report is based on data from City of Houston Comprehensive Annual Financial Report (CAFR) for Fiscal Year 2019 and other sources. Fiscal Year 2020 CAFR is yet to be published.