



# CITY OF HOUSTON

Finance Department

## Interoffice

Correspondence

**To:** City Council Members

**From:** Tantri Emo  
Chief Business Officer/Director of Finance

**cc:** Sylvester Turner, Mayor  
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**Date:** March 5, 2019

**Subject:** City of Houston Pension Update

Midway through the second full fiscal year following the historic pension reforms I am pleased to report that 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 is lower, 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 and Funded Ratio***

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, which would lower it by an additional \$1B, for a total reduction of \$3.9B. Based on the latest data as provided by the systems, including the reduction in liability due to the Pension Obligation Bonds, the reforms had the effect of cutting the NPL in half, to \$4.03B.

Net Pension Liability (\$ billions)	Municipal	Police	Fire	Total
Fiscal Year 2018 Actuarially Required Without Reform	3.18	3.44	1.59	8.21
Fiscal Year 2018 Post-Reform	2.12	1.26	0.64	4.03
Increase/(Decrease)	(1.06)	(2.18)	(0.94)	(4.18)

*Source: City of Houston Comprehensive Annual Financial Report.*

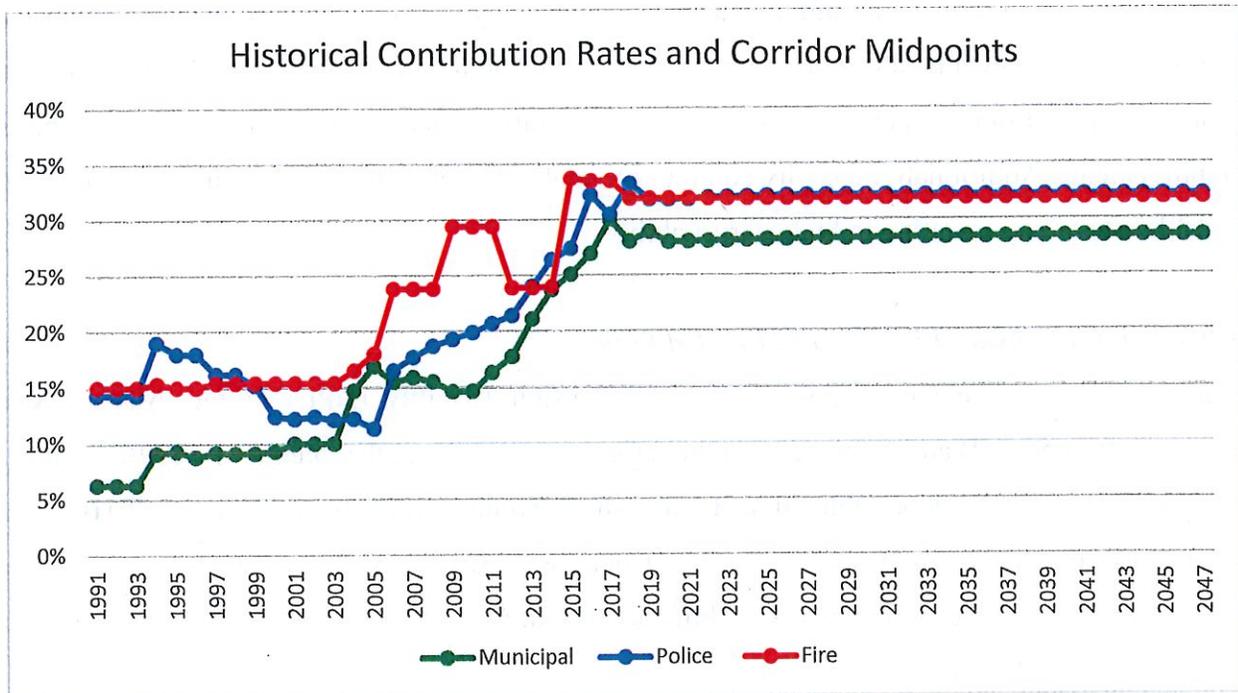
Another indicator of plan health is the funded ratio, which compares the assets to the total liabilities of the plan. This indicator has improved for the two consecutive fiscal years since the reforms were enacted.

Fiscal Year	Municipal	Police	Fire
2015	52%	62%	87%
2016	48%	62%	81%
2017	52%	68%	86%
2018	58%	81%	87%

*Source: City of Houston Comprehensive Annual Financial Report.*

***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 Year	Municipal		Police		Fire	
	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%	TBD	31.85%	TBD	32.99%	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.

(\$ in millions)	Municipal	Police	Fire	Total	YOY Increase
Fiscal Year	City Contribution	City Contribution	City Contribution	City Contribution	
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 (budgeted)	182.9	143.3	85.6	411.8	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.*

More importantly the annual cost avoidance is estimated at \$300M. This increase would have been required had the City made the full actuarially required contribution to fund the benefits in place pre-reform.

### ***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, 2018, released in December 2018, showed a substantial deterioration in the City's net position—going from \$1.855B to just \$792M—a swing of \$1.1B primarily due to a GASB change related to Other Post-Employment Benefits (OPEB).

### ***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).

In November 2018, a petition-initiated ballot initiative, Proposition B, was passed by voters, prompting Fitch to lower the City's outlook to negative. The proposition requires the city to bring firefighters pay (by rank) in line with that of Houston police officers'. It is estimated that this measure will cost the City approximately \$100M each fiscal year. The City is currently exploring options to implement Proposition B while minimizing service interruptions and layoffs by looking at options that seek to:

- Phase-in the cost over multiple years
- Reduce overall spending
- Identify additional revenue sources to pay for Proposition B