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[Houston's Plan to Cut Pension Costs in Half Overnight.]

Mayor Sylvester Turner is garnering praise for his proposal's comprehensiveness and balance.

Earlier this month, Houston Mayor Sylvester Turner released his outline for fixing the city's underfunded pension system, an issue that earned the city a credit rating downgrade in March.

Observers say the plan is the best effort yet at solving a problem that has eluded past city officials. If approved, the proposal would immediately cut Houston's unfunded liability by $3.5 billion — or nearly in half — while putting Houston on a path to pay off the rest of its pension debt over the next generation.

The proposal has several moving parts, including concessions from city workers, a requirement that the city make its payments going forward and a change in some accounting assumptions as a way of making the system less exposed to the risks of the financial market. It also calls for issuing pension obligation bonds to help plug the funding hole.

What makes the effort even more remarkable is that Turner is less than a year into his first term. But Turner is no ordinary first term mayor.

Prior to being elected, he had already spent 25 years serving a portion of the Houston metro area in the state legislature. It's his experience and the connections he's made, both politically and in the business community, that Turner will draw on when he takes the proposal to the city council in early October. The state legislature ultimately has final approval on any changes to the pension system, but most believe that Turner will encounter little resistance there.

"The number one thing is the relationships Mayor Turner has," said city finance director Kelly Dowe, whom Turner kept on from the previous administration. "When he says, 'Folks, this isn't sustainable,' it's different from someone else saying it."

Indeed, Turner's proposal appears to strike the right amount of give-and-take that's required for all parties to get on board. First, the city is stepping up in terms of accountability, meaning it would be required to make its pension payment annually.

What's more, the system would immediately incorporate a more realistic investment rate of return assumption in valuing its pension liabilities. Currently, Houston is an outlier among public plans and assumes its investments will earn 8 or 8.5 percent annually. That's much higher than the national average of plans and even higher than Houston's recent investment experience. Turner's proposal assumes a 7 percent rate of return, which is lower than the national average and bumps up Houston's total liabilities to a more realistic $7.7 billion (from under $4 billion as reported).

The pension plans would also switch from an open amortization period — which is like refinancing your home every year and never paying off the loan — to a closed one. That change puts the city on a path to fully pay off its pension debt over 30 years.

In terms of employee concessions, Turner is deftly leaving it up to the unions. At a press conference announcing the reform, he said the three plans in the pension system had identified a collective $2.5 billion in cuts. While not specific, that will likely mean some combination of cuts to retirees' cost-o--living adjustments and their deferred retirement option plans benefits, which allow retirement-age employees to keep earning retirement benefits as they continue to work.

The planned issuance of pension obligation bonds would infuse another $1 billion into the system, bringing down the total unfunded liability to about $4.2 billion. Issuing bonds to plug pension funding holes can be controversial because it doesn't eliminate debt, it simply moves it from a pension system's balance sheets to the city's debt ledger.

City Controller Chris Brown said at a discussion last week hosted by Rice University's Kinder Institute that he is typically skeptical of issuing pension obligation bonds. But he added he would support the idea as long as the city doesn't use the bonds as a replacement for making its annual payments and if Houston receives a favorable interest rate on the bonds.

Notably, Turner's proposal doesn't call for a new tax as has often been done in other places — such as Chicago — as a way to get a poorly funded pension plan back to health. That aspect has pleased the business community, which has said it wants the city to get its pension costs under control before discussing taxes. But Turner does plan to ask city voters next year to lift Houston's 12-yea--old revenue cap to help reinvest in needed infrastructure and parks projects.

So far, the Houston Municipal Employees Pension System and the Houston Police Officers' Pension System have signed on to the mayor's plan. That leaves the Houston Firefighters' Relief and Retirement Fund, which has yet to endorse Turner's proposal. The firefighters' plan is directly controlled by the legislature. That means if they don't sign on to the reform, they risk "the horrendous challenge" of the legislature making changes to their plan, said Max Patterson, the executive director of the Texas Association of Public Employee Retirement Systems.

"Generally speaking, [employees] should be happy with this," he said at last week's event. "Because you have to measure it against the other side of, if I don't get this, what will I get?"

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BY LIZ FARMER | SEPTEMBER 29, 2016