

# **Bond Case Briefs**

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## **In Texas, Some Rare Good News About Cities With Pension Woes.**

Detroit. Stockton. Puerto Rico. The list of places bankrupted by ballooning pension obligations and other debts is growing. But now comes some good news about two cities, Dallas and Houston, that have pulled back from the brink.

Just six months ago, the mayor of Dallas, Michael S. Rawlings, was warning that his city might need to declare bankruptcy after a panic led stampeding retirees to pull half a billion dollars out of its pension fund for police officers and firefighters.

But instead of going to bankruptcy court, Mr. Rawlings went to Austin, the state capital, to lobby for state pension laws that would stop the bleeding. So did the mayor of Houston, Sylvester Turner, who faced other pension problems and had persuaded the city's labor groups to agree to concessions worth \$1.3 billion over the next 30 years.

The resulting legislation — which essentially averts crises in Texas' biggest and third-biggest cities — was signed into law by Gov. Greg Abbott on Wednesday.

Each city had its own bill, because each had its own unique problems. But both bills involve measured reductions in pension accruals for workers and retirees — mainly in secondary benefit categories like inflation adjustments and lump-sum payouts. In exchange, the pension funds will receive more money from the cities to protect the core benefits.

Most important, both bills establish financial benchmarks for the coming years. If the pension funds do not meet them, there will be more benefit cuts, some of which could be steep. The point of this is to keep elected officials from giving the can one good kick down the road now, then declaring victory and turning their backs while the same intractable problems are festering under the surface.

"The key to all this is, not one retiree's pension check is going to be reduced one penny," said Ray Hunt, the president of the Houston Police Officers Union. "It just means that future increases are slowed or stopped. I believe the majority of our members think this is the responsible way."

As happy as the resolution may seem, the steps that Texas took are illegal in other places where public pensions are imperiling the finances of cities and states. Illinois, California, Oregon, Pennsylvania and Kansas are among the states where, by law, public pensions cannot be reduced — not even the pensions that current workers hope to earn in the future.

That doctrine, known as the California Rule, explains why California cities like Vallejo and Stockton reduced their payments to other creditors when they went into bankruptcy but did not touch their workers' costly pension plans.

Of all labor groups in the public sector, police and firefighters' unions tend to be the California Rule's most ardent champions. When Memphis recently tried to scale back pensions, for example, half the police force called in sick and hundreds of others resigned.

Police unions in California are now pushing a critical test of the California Rule through the courts, after a lower court ruled that they did not have “an immutable entitlement” to the best pension they could hope for, but “only to a ‘reasonable’ pension.” Final adjudication appears to be many months away.

Against that forbidding backdrop, Dallas and Houston show there is still room for compromise (although Houston’s firefighters did withdraw their support for the bill that was just signed into law).

Both cities were spurred to act by the risk of credit downgrades and by a recent accounting change that calls for cities to calculate the number of years before their pension funds will run out of money — a once-unthinkable catastrophe that has come to pass in Prichard, Ala.; Central Falls, R.I.; and now Puerto Rico.

Those developments — and Detroit’s bankruptcy — have shown that Washington will not bail out government pension funds that go bust; officials had to patch together money from other sources, and even then, the retirees of Prichard, Central Falls and Detroit had their benefits cut. Cuts are expected soon in Puerto Rico, too.

Seeing that, and knowing that the doomsday clock was also ticking in Dallas and Houston, made labor leaders in those cities conclude that fighting concessions to the finish would not, in the end, protect their members. The Dallas pension fund was on track to run out of money in 10 years, and Houston’s in less than 15.

And in both cities, the police and firefighters have opted out of Social Security, something state and local workers often do in hopes of avoiding the Social Security payroll tax. Federal law allows that, but if a government pension fund collapses, older adults are left without a backstop.

“We have to have a fair pension system, both for us and for taxpayers,” said Mr. Hunt of the Houston police union. “It’s either that or take a 100 percent pension cut in the future, when you have no pension fund.”

Josh McGee, the chairman of the Texas Pension Review Board, a state oversight body, called Houston’s overhaul “one of the most comprehensive I’ve seen in the country,” and all the more notable because the mayor who pushed it through is a labor-friendly Democrat.

As for the Dallas pension measure, Mr. McGee called it a good first step.

“Dallas waited until they were in crisis before they did anything, so it’s really, really painful, and it’s going to take more actions in the future to solve the problem,” he said.

Dallas’s measure includes raising the retirement age, slowing benefit accruals, ending most cost-of-living increases and raising each worker’s required pension contribution to 13.5 percent of pay, from 8.5 percent.

Importantly, the new law for Dallas also bans the kind of big, one-time withdrawals that caused last year’s run, in which retirement-age police and firefighters stripped about \$500 million out of their pension fund, leaving it tattered almost beyond repair.

Such lump-sum withdrawals were allowed under a fairly common program known as a DROP, for deferred retirement option program, but they caused a stampede after workers learned that the pension fund had been overstating its assets.

The workers started to grab cash for fear that it would not be there later if they waited. Hundreds of people qualified for payments over \$1 million each, in addition to their regular pensions.

The changes approved Wednesday are not expected to turn the fund around, only to stabilize it. The law calls for Dallas to stress-test the fund in seven years and to make more cuts if it fails. City officials have warned that they may still claw back some of the money people took during last year's run.

On Thursday, Fitch, the credit-rating agency, said it would review Dallas's rating. The city had been on a watch list for likely downgrades because of pension risks.

Houston had different pension troubles, dating to 2001, when officials decided that the bull market of the 1990s justified big benefit increases. The dot-com crash quickly showed that the decision was a mistake, but instead of revoking the increase, the city coped by not making its yearly contributions to the fund.

"The city was on a path to bankruptcy, and we just realized we were going to have to have some kind of reform," said Mark Watts, the head of the Greater Houston Partnership's municipal finance task force.

Under the new law, Houston reduces certain secondary pension benefits, like a DROP feature and cost-of-living increases, in exchange for better funding.

If costs still keep rising too sharply, the law calls for further reductions. And if that does not work, the system automatically shuts down the defined-benefit plan and switches to a hybrid, called a cash-balance plan.

"That caps the city's downside risk," said Mr. McGee, of the Texas Pension Review Board.

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