

Financial Statements and Report of  
Independent Certified Public Accountants

**Port of Houston Authority**  
**Restated Retirement Plan**

July 31, 2018 and 2017

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## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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Pension and Benefits Committee  
Port of Houston Authority Restated Retirement Plan  
Port Commission of the Port of Houston Authority of Harris County, Texas

We have audited the accompanying financial statements of the Port of Houston Authority Restated Retirement Plan (the "Plan"), which comprise the statements of fiduciary net position as of July 31, 2018 and 2017, and the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements.

### Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Plan's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, information regarding the Port of Houston Authority Restated Retirement Plan's fiduciary net position as of July 31, 2018 and 2017, and changes therein for the years then ended in accordance with accounting principles generally accepted in the United States of America.

#### Required Supplementary information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the schedule of changes in net pension liability and related ratios, schedule of contributions, and schedule of investment returns on pages 3-5 and 21-23, respectively, be presented to supplement the financial statements. Such information, although not a required part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. This required supplementary information is the responsibility of management. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America. These limited procedures consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### Other reporting required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report, dated January 23, 2019, on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Plan's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Plan's internal control over financial reporting and compliance.



Houston, Texas  
January 23 2019

## Port of Houston Authority Restated Retirement Plan

### Management's Discussion and Analysis

July 31, 2018 and 2017

(Unaudited)

As management of the Port of Houston Authority of Harris County, Texas (the "Authority"), we offer readers of the Port of Houston Authority Restated Retirement Plan's (the "Plan") financial statements this narrative overview and analysis of the financial activities of the Plan for the fiscal years ended July 31, 2018 and 2017.

### Financial highlights

The net position restricted for pensions (the "net position") of the Plan at July 31, 2018, 2017 and 2016 was \$184,287,781, \$176,993,428, and \$163,311,014, respectively. This net position is restricted for the payment of future employee pension benefits. Overall, the financial position of the Plan increased for the fiscal year ended July 31, 2018 ("FY2018").

The Plan's net position increased by \$7,294,353 and \$13,682,414 for fiscal years 2018 and 2017 ("FY2018", "FY2017"), respectively and decreased \$3,545,911 for fiscal year 2016 ("FY2016"). The increase in net position for FY 2018 was attributed to unrealized gains on Plan investments. FY2017 was primarily attributed to unrealized gains in Plan investments combined with an increase in employer contributions. The decrease in net position for FY2016 was due primarily to a reduction in net investment income, despite an increase in employer contributions.

The Plan investments had a net appreciation in fair value of \$7,669,429 and \$9,863,761 for FY2018, FY2017, respectively and a net depreciation in fair value of \$2,501,547 for FY2016. The net increase and decrease in fair values were largely due to realized gains and losses, respectively, on equity investments.

Additions to the Plan are made primarily through contributions from the Authority. These contributions totaled \$5,256,900, \$9,600,000, and \$4,500,000, for the years ended July 31, 2018, 2017, and 2016, respectively. The increase in contributions from 2016 to 2017 is due primarily to additional funding of \$4,000,000 authorized by the Commission to partially offset the increase in the Plan's unfunded actuarial accrued liability resulting from a change in the discount rate from 7.00% to 6.75%.

Investment returns consist of interest earnings, dividend income, and net appreciation or depreciation in fair value of investments.

The following table shows the actual asset allocation of Plan investments, by major asset category, for the fiscal years ended July 31, 2018, 2017 and 2016:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Asset allocation:			
Domestic and foreign equities	49%	48%	47%
Fixed income investments	42	42	42
Master Limited Partnerships	8	8	9
Cash and cash equivalents	1	2	2

## Port of Houston Authority Restated Retirement Plan

Management's Discussion and Analysis  
July 31, 2018 and 2017  
(Unaudited)

Benefit payments are the primary expense of the Plan. Such payments totaled \$10,084,820, \$9,858,352, and \$9,552,117, for the years ended July 31, 2018, 2017, and 2016, respectively. Benefit payments across all periods remained at a reasonable level. Other expenses of the Plan include administrative expenses, which totaled \$255,300, \$279,696, and \$234,464 for the years ended July 31, 2018, 2017, and 2016, respectively. The fluctuations in administrative expenses across the time periods presented result from the use of various service providers for legal, actuarial and other services on an as-needed basis.

Net position restricted for pensions, the excess of contributions and investment income over benefit payments and administrative and investment expenses, is accumulated by the Plan in order to meet future pension benefit obligations.

	2018	2017	2016
Assets:			
Cash and cash equivalents	\$ 2,695,860	\$ 3,700,267	\$ 3,945,750
Investments	180,807,927	172,611,929	158,642,250
Accrued investment income	839,852	734,430	777,571
Total assets	184,343,639	177,046,626	163,365,571
Liabilities:			
Accrued administrative and investment expenses	55,858	53,198	54,557
Total liabilities	55,858	53,198	54,557
Net position restricted for pensions	\$ 184,287,781	\$ 176,993,428	\$ 163,311,014

**Port of Houston Authority Restated Retirement Plan**

Management's Discussion and Analysis  
July 31, 2018 and 2017  
(Unaudited)

Condensed Statements of Changes in Fiduciary Net Position

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Additions:			
Contributions	\$ 5,256,900	\$ 9,600,000	\$ 4,500,000
Net investment income	<u>12,377,573</u>	<u>14,220,462</u>	<u>1,740,670</u>
Total additions	17,634,473	23,820,462	6,240,670
Deductions:			
Benefit payments	10,084,820	9,858,352	9,552,117
Administrative expenses	<u>255,300</u>	<u>279,696</u>	<u>234,464</u>
Total deductions	<u>10,340,120</u>	<u>10,138,048</u>	<u>9,786,581</u>
Net increase (decrease) in net position	7,294,353	13,682,414	(3,545,911)
Net position restricted for pensions			
Beginning of year	<u>176,993,428</u>	<u>163,311,014</u>	<u>166,856,925</u>
End of year	<u>\$ 184,287,781</u>	<u>\$ 176,993,428</u>	<u>\$ 163,311,014</u>

**Requests for Information**

The financial report is designed to provide an overview of the Authority's finances for those with an interest in the Authority's pension finances. Questions concerning the information provided in this report, or requests for additional information, should be addressed to the Office of the Controller, Port of Houston Authority, 111 East Loop North, Houston, Texas 77029.

**Port of Houston Authority Restated Retirement Plan**

Statements of Fiduciary Net Position  
As of July 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Assets:		
Cash and cash equivalents	\$ 2,695,860	\$ 3,700,267
Investments	180,807,927	172,611,929
Accrued investment income	<u>839,852</u>	<u>734,430</u>
Total assets	184,343,639	177,046,626
Liabilities:		
Accrued administrative and investment expenses	<u>55,858</u>	<u>53,198</u>
Total liabilities	55,858	53,198
Net position restricted for pensions	<u>\$ 184,287,781</u>	<u>\$ 176,993,428</u>

The accompanying notes are an integral part of these financial statements.



**Port of Houston Authority Restated Retirement Plan**

Statements of Changes in Fiduciary Net Position  
As of July 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Additions:		
Employer contributions	\$ 5,256,900	\$ 9,600,000
Investment income:		
Net appreciation in fair value	7,669,429	9,863,761
Interest	2,835,728	2,628,708
Dividends	2,533,265	2,411,780
Other	823	10
Total investment income	<u>13,039,245</u>	<u>14,904,259</u>
Investment expenses	<u>(661,672)</u>	<u>(683,797)</u>
Net investment income	<u>12,377,573</u>	<u>14,220,462</u>
Total additions	<u>17,634,473</u>	<u>23,820,462</u>
Deductions:		
Retirement benefits	10,084,820	9,858,352
Administrative expenses	255,300	279,696
Total deductions	<u>10,340,120</u>	<u>10,138,048</u>
Net increase in net position	7,294,353	13,682,414
Net position restricted for pensions		
Beginning of year	<u>176,993,428</u>	<u>163,311,014</u>
End of year	<u>\$ 184,287,781</u>	<u>\$ 176,993,428</u>

The accompanying notes are an integral part of these financial statements.

## Port of Houston Authority Restated Retirement Plan

### NOTES TO THE FINANCIAL STATEMENTS For the Years Ended July 31, 2018 and 2017

The following brief description of the Port of Houston Authority Restated Retirement Plan (the “Plan”) is provided for general informational purposes only. Reference should be made to the Plan document for more complete information.

**General** - The Plan is a single-employer noncontributory defined benefit pension plan sponsored and administered by the Port of Houston Authority of Harris County, Texas (the “Authority” or the “Plan Sponsor”). As a governmental plan, the Plan is not subject to the Employee Retirement Income Security Act of 1974 (“ERISA”). Three members of the Port Commission of the Authority (“the Commission”) serve as the Pension and Benefits Committee (“Committee”) responsible for providing advice and recommendations to the Commission and assisting the Commission in performing its responsibilities for the Plan. The Authority controls and manages the operation and administration of the Plan. The seven-member Commission, appointed by the Harris County Commissioners Court, City of Houston, Texas, City of Pasadena, Texas and the Harris County Mayors’ and Councils’ Association, maintains the authority to amend the Plan provisions and the investment policy as necessary. As fiduciaries, Commissioners and Authority staff shall act solely in the interest of the participants and beneficiaries of the Plan. Compass Bank serves as the trustee of the Plan.

#### NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### 1. Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Measurement focus refers to the definition of the resource flows measured.

The Plan is subject to the pronouncements of the Governmental Accounting Standards Board (“GASB”). The Plan is maintained on the full accrual basis of accounting and the economic resources measurement focus. All economic resources, including financial assets and related liabilities, both current and long term, and the changes therein are reported in the Plan’s financial statements. Revenues, including contributions, are recognized when earned, and expenses are recognized when the underlying transaction or event occurs, regardless of the timing of related cash flows.

##### 2. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein, disclosure of contingent assets and liabilities, and the actuarial present value of accumulated Plan benefits and changes therein at the date of the financial statements. Actual results could differ from these estimates.

##### 3. Risks and Uncertainties

The Plan utilizes various investment securities, including U.S. government securities, corporate debt instruments, money market funds and corporate stock. Investment securities, in general, are exposed to various risks, including interest rate risk, credit risk, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED  
For the Years Ended July 31, 2018 and 2017

**NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED**

**4. Cash and Cash Equivalents**

Cash and short-term investments with original maturities of three months or less when purchased are considered cash equivalents.

**5. Investment Valuation and Income Recognition**

Investments are stated at fair value. Quoted market prices are used in determining fair value of Plan assets. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

**6. Administrative and Investment Expenses**

The Plan's expenses are paid by the Plan as provided in the Plan document.

**7. Payment of Benefits**

Cash payments to participants for benefits are recorded upon distribution.

**NOTE B – PLAN DESCRIPTION**

**1. Contributions**

Contributions to provide benefits under the Plan are made solely by the Authority. The Authority's funding policy adopted on September 14, 1997 prescribes a contribution equal to 100% of the cost of benefits earned by Plan members plus an additional amount to finance any unfunded accrued liability and may be amended by the Commission at its discretion. This method and the actuarial assumptions have been designed to provide sufficient funds to pay benefits as they become payable under the Plan. The policy was amended by the Commission on July 28, 2015 to allow the Authority's staff the flexibility to fund the Plan throughout the year without seeking further authorization from the Commission, provided the aggregate contributions in a fiscal year do not exceed 105% of the annual required contribution as calculated by the Authority's actuary. For FY2017, the Commission approved aggregated contributions in excess of 105% of the annual required contribution to partially offset the impact of reducing the discount rate from 7.00% to 6.75%. The Authority made contributions of \$5,256,900 and 9,600,000 for FY2018 and FY2017, respectively.

**2. Eligibility**

All permanent, full-time employees hired prior to August 1, 2012 are eligible for the Plan. On December 16, 2014, the Port Commission approved a Third Amendment to the Plan which, among other things, modified the definition of eligible employee. The Plan was amended and restated effective as of October 24, 2017 to modify the periods of service credited to totally and permanently disabled participants, and to clarify the benefits, powers, authorities, duties, and responsibilities provided under the Plan. Employees become vested after five continuous years of service, as defined by the Plan. Fully vested employees are entitled to Plan benefits upon retirement. There is no partial vesting of benefits.

## Port of Houston Authority Restated Retirement Plan

### NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

For the Years Ended July 31, 2018 and 2017

#### NOTE B – PLAN DESCRIPTION – Continued

Employees hired on or after August 1, 2012 are not eligible for the Plan. They participate in a defined contribution retirement benefit plan sponsored by the Authority, which is operated and administered separately from this Plan.

#### 3. Benefit Payments

The Plan provides for normal retirement benefits upon reaching the age of 65 and has provisions for early retirement, death and disability benefits. Benefits under the Plan are determined based on a final pay formula. Generally, the final pay formula is calculated as a percentage of earnings multiplied by years of credited service with certain adjustments, as provided in the Plan. Participants may elect to receive their pension benefits from various forms of single life or joint and survivor annuities. Certain participants may receive a lump sum payment. Cost-of-living adjustments are provided at the discretion of the Commission.

#### 4. Plan Membership

The number of plan members consisted of the following at August 1, 2018 and 2017, the date of the two latest actuarial valuations:

	<u>2018</u>	<u>2017</u>
Retirees and beneficiaries receiving payments	529	530
Terminated vested participants not yet receiving benefits	178	191
Disabled participants	10	12
Active participants	<u>355</u>	<u>370</u>
Total	<u>1,072</u>	<u>1,103</u>

#### NOTE C – INVESTMENTS

The investment strategy of the Plan as administered by the Commission is to preserve principal while emphasizing relative total return versus the liability growth rate and to maintain sufficient income or liquidity in order to pay monthly benefits.

The Plan's investment policy may be amended by the Commission by a majority vote of its members. The investment policy is reviewed at least annually. It was amended on July 25, 2017 to clarify that the Plan is a public retirement system subject to Chapter 802, Texas Government Code and, in accordance with that Chapter, the Commission, as governing body, has the fiduciary responsibility for Plan assets, including overseeing the investment and expenditure of funds and the administration of benefits. A copy of the investment policy is available on the Authority's website ([www.porthouston.com](http://www.porthouston.com)).

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

For the Years Ended July 31, 2018 and 2017

**NOTE C – INVESTMENTS – Continued**

The Commission is responsible for approving the total asset allocation among stocks, bonds and cash. The Commission adopted the following asset allocation parameters as a general guideline in investing the Plan's assets:

Asset Class	Minimum	Target	Maximum
Large Cap Domestic Equity	10.0%	15.0%	20.0%
Mid Cap Domestic Equity	2.5%	7.5%	12.5%
Small Cap Domestic Equity	5.0%	10.0%	15.0%
International Equity	2.5%	7.5%	12.5%
Core Fixed Income	35.0%	40.0%	45.0%
High Yield Fixed Income	0.0%	5.0%	10.0%
Real Estate	0.0%	5.0%	10.0%
Master Limited Partnerships	5.0%	10.0%	15.0%
Total Asset Allocation		100.0%	

As outlined above, the Plan invests in fixed income securities, equity securities, real estate and master limited partnerships. In addition, the Plan's fixed income assets may be held in cash and cash equivalents (e.g., commercial paper, money market mutual funds, etc.), U.S. treasuries, U.S. government agency bonds, and other short-term and long-term debt securities, provided such instruments comply with investment policy guidelines, especially those relating to credit quality and diversification.

The Plan's assets are rebalanced in line with the above asset allocation parameters from time to time.

The Plan's cash and cash equivalents and investments are held by a bank-administered trust fund. Fair values of these assets at July 31, 2018 and 2017 are as follows:

	2018	2017
Fixed income investments	\$ 76,834,416	\$ 74,161,487
Money market funds	2,695,860	3,700,267
Equity investments:		
Domestic	83,839,733	79,310,282
Foreign	2,883,055	3,172,937
Total equity investments	86,722,788	82,483,219
Other (Foreign convertible securities and domestic LLPs and LLCs)	17,250,723	15,967,223
Total	<u>\$ 183,503,787</u>	<u>\$ 176,312,196</u>

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED  
For the Years Ended July 31, 2018 and 2017

**NOTE C – INVESTMENTS – Continued**

For purposes of the Plan’s financial statements, fair value is generally defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. For the Plan, such fair values are provided by third-party market pricing sources utilized by Compass Bank as trustee and custodian of the Plan’s assets, and reflected on the monthly and annual custody statements provided to the Authority.

The Plan’s investments during the year ended July 31, 2018 and 2017 (including realized gains and losses on investments) depreciated/appreciated in total value as follows:

	<u>2018</u>	<u>2017</u>
Fixed income investments	\$ (2,960,054)	\$ (1,023,040)
Equity investments	<u>10,629,483</u>	<u>10,886,801</u>
Total	<u>\$ 7,669,429</u>	<u>\$ 9,863,761</u>

During the fiscal years ended July 31, 2018 and 2017, interest and dividends earned and other income on the Plan’s investments amounted to \$5,369,816 and \$5,040,498, respectively.

As of July 31, 2018 and 2017, the Plan had the following investments in its fixed income accounts:

<u>Investment Type</u>	<u>2018</u>		<u>2017</u>	
	<u>Fair value</u>	<u>Percentage of total</u>	<u>Fair value</u>	<u>Percentage of total</u>
U.S. treasuries	\$ 11,834,857	15.40 %	\$ 12,309,292	16.60 %
U.S. government agencies	12,904,838	16.80	13,560,651	18.29
Corporate obligations	42,203,935	54.93	39,205,127	52.86
Mutual fund	9,348,579	12.17	9,086,417	12.25
Municipal obligations	<u>542,207</u>	<u>0.70</u>	<u>-</u>	<u>-</u>
	<u>\$ 76,834,416</u>	<u>100.00 %</u>	<u>\$ 74,161,487</u>	<u>100.00 %</u>

In accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, financial statements are required to address credit risk, concentration of credit risk, interest rate risk, and foreign currency risk of investments.

## Port of Houston Authority Restated Retirement Plan

### NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

For the Years Ended July 31, 2018 and 2017

#### NOTE C – INVESTMENTS – Continued

##### 1. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. To minimize this risk, the Plan's investment policy does not allow any fixed income securities below the rating of B, and no more than 20% in bonds rated below investment grade. Securities are considered investment grade if they are rated Baa3 or higher by Moody's Investor Service, or BBB- or higher by Standard and Poor's or Fitch Ratings. U.S. treasuries and U.S. government agency bonds are rated Aaa/AA+/AAA by Moody's, Standard and Poor's and Fitch, respectively. The Plan's investments in corporate obligations have credit ratings that range from B3/B/B up to Aaa/AAA/AAA.

##### 2. Concentration of Credit Risk

Concentration of credit risk exists when investments are concentrated in one issuer. The Plan's investment policy limits the amount that may be invested in any one issuer.

As of July 31, 2018 and 2017, the Plan had the following investments in excess of 5% of total investments:

	<u>2018</u>	<u>2017</u>
Vanguard Inst Index (Cusip 922040100)	\$ 14,170,794	\$ 13,707,636
Causeway International Value-Institutional (Cusip 14949P208)	12,934,360	14,316,839
Cohen & Steers Institutional Realty Shares (Cusip 19247U106)	9,965,925	-
Loomis Sayles Institutional High Income (Cusip 543495600)	9,348,579	9,086,416
Total	<u>\$ 46,419,658</u>	<u>\$ 37,110,891</u>

##### 3. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the Plan's investments. Duration is a measure of interest rate risk and measures a bond's price sensitivity to a 100-basis-point change in interest rates. The greater the duration of a bond, or a portfolio of bonds, the greater its price volatility will be in response to a change in interest rates. A duration of 8 would mean that, given a 100-basis-point change up or down in rates, a bond's price would move up or down by 8%.

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

For the Years Ended July 31, 2018 and 2017

**NOTE C – INVESTMENTS – Continued**

The following table details the U.S. dollar bond holdings and their duration by fund manager as of July 31, 2018 and 2017:

	Smith Graham		MacKay Shields, LLC		Total fair value
	Fair value	Duration in years	Fair value	Duration in years	
<u>2018</u>					
U.S. treasuries	\$ 4,532,858	9.35	\$ 7,301,999	8.87	\$ 11,834,857
U.S. government agencies	6,117,712	5.17	6,787,126	5.28	12,904,838
Corporate obligations	22,639,647	4.97	19,564,288	5.07	42,203,935
Municipal obligations	542,207	7.37	-	-	542,207
Total fair value	<u>\$ 33,832,424</u>		<u>\$ 33,653,413</u>		<u>\$ 67,485,837</u>
Portfolio average duration		5.63		5.94	
<u>2017</u>					
U.S. treasuries	\$ 7,628,754	5.28	\$ 4,680,538	9.77	\$ 12,309,292
U.S. government agencies	6,475,287	3.58	7,085,364	4.67	13,560,651
Corporate obligations	18,313,947	6.96	20,891,180	5.46	39,205,127
Total fair value	<u>\$ 32,417,988</u>		<u>\$ 32,657,082</u>		<u>\$ 65,075,070</u>
Portfolio average duration		5.89		5.91	

**4. Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Plan holds investments in American Depositary Receipts (“ADRs”) which have currency risk; however, they are not included in foreign currency as they are denominated in U.S. dollars and accounted for at fair market value. The Plan had indirect exposure to foreign currency risk of \$18,527,745 and \$19,665,162, through its investments in international mutual funds, foreign stock and convertible securities as of July 31, 2018 and 2017, respectively.

**Annual Money-Weighted Rate of Return**

For the year ended July 31, 2018, the annual money-weighted rate of return on Plan investments, net of investment expense, was 5.60%. The money-weighted rate of return expresses investment performance, net of investment expenses, adjusted for the changing amounts actually invested.



**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

For the Years Ended July 31, 2018 and 2017

**NOTE C – INVESTMENTS – Continued**

**5. Fair Value of Investments**

The Plan has estimated fair value of financial instruments in accordance with the fair value guidance provided in accordance with GASB 72. The Plan’s significant financial instruments consist of cash and cash equivalents, investments and other liabilities. The carrying amounts for cash and cash equivalents and other liabilities approximate fair value because of the short-term nature of these items.

Determining the level at which an asset or liability falls within the hierarchy requires significant judgment considering the lowest level input that is significant to the fair value measurement as a whole. The hierarchy consists of three broad levels, as follows, with Level 1 being the most observable:

Level 1 - Quoted market prices in active markets for identical assets or liabilities.

Level 2 - Quoted market prices in active or inactive markets for similar assets or liabilities and inputs other than quoted prices that are observable.

Level 3 - Unobservable inputs for an asset or liability, which reflect those that market participants would use.

The following tables represent information about the Plan’s long-term investments that are measured at fair value as of July 31, 2018 and 2017, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

<u>2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Common stock	\$ 60,939,448	\$ -	\$ 60,939,448
Foreign stock	2,883,055	-	2,883,055
Mutual Funds	32,248,864	-	32,248,864
U.S. treasuries	11,834,857	-	11,834,857
U.S. corporate obligations	-	42,203,935	42,203,935
Municipal obligations	-	542,207	542,207
U.S. government agencies	-	12,904,838	12,904,838
Foreign convertibles	-	2,710,329	2,710,329
Master limited partnerships	14,540,394	-	14,540,394
Total	<u>\$ 122,446,618</u>	<u>\$ 58,361,309</u>	<u>\$ 180,807,927</u>

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

For the Years Ended July 31, 2018 and 2017

**NOTE C – INVESTMENTS – Continued**

<u>2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Common stock	\$ 56,279,888	\$ -	\$ 56,279,888
Foreign stock	3,172,937	-	3,172,937
Mutual Funds	32,116,810	-	32,116,810
U.S. treasuries	12,309,292	-	12,309,292
U.S. corporate obligations	163,902	39,041,225	39,205,127
U.S. government agencies	-	13,560,652	13,560,652
Foreign convertibles	-	2,175,386	2,175,386
Master limited partnerships	13,791,837	-	13,791,837
Total	<u>\$ 117,834,666</u>	<u>\$ 54,777,263</u>	<u>\$ 172,611,929</u>

**NOTE D – NET PENSION LIABILITY**

The net pension liability is to be measured as the total liability less the amount of the pension plan's fiduciary net position. The table below illustrates the calculation for the net pension liability.

<u>Net pension liability</u>	<u>July 31, 2018</u>	<u>July 31, 2017</u>
Total pension liability	\$ 189,631,184	\$ 187,270,165
Fiduciary net position	184,287,781	176,993,428
Net pension liability	5,343,403	10,276,737
Fiduciary net position as a % of total pension liability	97.18%	94.51%
Covered payroll	29,960,300	30,210,365
Net pension liability as a % of covered payroll	17.83%	34.02%

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED  
For the Years Ended July 31, 2018 and 2017

**NOTE D – NET PENSION LIABILITY – Continued**

**1. Actuarial Assumptions**

The total pension liability was determined by an actuarial valuation as of August 1, 2016 and rolled forward to the measurement date of July 31, 2018, the Plan's fiscal year end, using the following actuarial assumptions applied to all periods included in the measurement. These actuarial assumptions were based on the results of an actuarial experience study for the period August 1, 2009 through August 1, 2015.

	2018	2017
Valuation date	August 1, 2016	August 1, 2016
Measurement date	July 31, 2018	July 31, 2017
Actuarial cost method	Entry age normal	Entry age normal
Amortization method	Level dollar method	Level dollar method
Equivalent single amortization period of the unfunded liabilities	30 years	30 years
Asset valuation method	Market value	Market value
Actuarial assumptions:		
Investment rate of return	6.75%	6.75%
Projected salary increases	2.5% to 10.0%	2.5% to 10.0%
Inflation	2.50%	2.50%
Cost-of-living adjustment	None	None
Mortality	RP-2016 Mortality for Employees, Healthy Annuitants, and Disable Annuitants with generational projection per MP-2016	RP-2014 Mortality for Employees, Healthy Annuitants, and Disable Annuitants with generational projection per MP-2015

**2. Long-Term Rate of Return**

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future rates of return (expected returns, net of pension plan investment expense) are developed for each major asset class.

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED  
For the Years Ended July 31, 2018 and 2017

**NOTE D – NET PENSION LIABILITY – Continued**

These ranges are combined to produce the long-term expected rate of return by weighting the expected future rates of return by the target asset allocation percentage. Best estimates of arithmetic rates of return for each major asset class included in the Plan’s target asset allocation as of July 31, 2018 are summarized in the following table:

Asset class	Index	Target allocation	Long-term expected rate of return*
Core Fixed Income	Bloomberg Barclays U.S. Aggregate	40.0%	2.5%
High Yield Fixed Income	BofA Merrill Lynch High Yield II	5.0%	2.5%
Large Cap U.S. Equity	S&P 500	15.0%	7.5%
Mid Cap U.S. Equity	Russell Mid Cap	7.5%	7.5%
Small Cap U.S. Equity	Russell 2000	10.0%	7.5%
Developed Foreign Equity	MSCI EAFE	7.5%	8.5%
Real Estate (REIT)	FTSE NAREIT Equity REIT	5.0%	4.5%
Master Limited Partnership	Alerian MLP	10.0%	7.5%
	Long-term expected (weighted) rate of return:		5.10%
	Actuarial assumed long-term investment rate of return or Discount rate:		6.75%

\*Assumed rates of return utilized by the Plan’s investment consultant for the current fiscal period’s allocation.

**3. Discount Rate**

The discount rate used to measure the total pension liability was 6.75 percent. The projection of cash flows used to determine the discount rate assumed that the Authority contributions will be made at rates equal to the actuarially determined contribution. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 6.75% on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

	July 31, 2018	July 31, 2017
Discount rate	6.75%	6.75%
Long-term expected rate of return, net of investment expense	6.75%	6.75%
Municipal bond rate	N/A	N/A

**Port of Houston Authority Restated Retirement Plan**

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

For the Years Ended July 31, 2018 and 2017

**NOTE D – NET PENSION LIABILITY – Continued**

**4. Sensitivity of the Net Pension Liability to Changes in the Discount Rate**

The following presents the net pension liability of the Authority, calculated using the discount rate of 6.75 percent, as well as what the Authority’s net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (5.75 percent) or 1-percentage point higher (7.75 percent) than the current rate:

	1% decrease 5.75%	Current discount rate 6.75%	1% increase 7.75%
	<hr/>	<hr/>	<hr/>
Net pension liability (asset)	27,320,061	5,343,403	(13,191,560)

**NOTE E – PLAN TERMINATION**

Although it has not expressed any intention to do so, the Commission and the Authority have the right under the Plan, in certain circumstances, to discontinue its contributions at any time and to terminate the Plan subject to the Plan provisions. In the event that the Plan is terminated, the net position of the Plan will be allocated for payment of benefits to the participants in an order of priority determined in accordance with the Plan document and the Internal Revenue Code.

REQUIRED SUPPLEMENTARY INFORMATION

(Unaudited)

**Port of Houston Authority Restated Retirement Plan**

SCHEDULE OF CHANGES IN NET PENSION LIABILITY AND RELATED RATIOS  
Last Four Fiscal Years

	<u>July 31, 2018</u>	<u>July 31, 2017</u>	<u>July 31, 2016</u>	<u>July 31, 2015</u>
<b>Total pension liability:</b>				
Service cost	\$ 3,402,422	\$ 3,198,269	\$ 3,228,805	\$ 3,186,015
Interest on total pension liability	12,454,101	12,251,337	11,883,003	10,939,999
Effect of economic/demographic (losses)	(1,207,309)	(116,722)	(694,543)	(1,277,703)
Effect of assumption changes or inputs	(2,203,375)	5,012,275	-	9,568,882
Benefit payments	(10,084,820)	(9,858,352)	(9,552,117)	(9,590,546)
Net change in total pension liability	2,361,019	10,486,807	4,865,148	12,826,647
Total pension liability, beginning	187,270,165	176,783,358	171,918,210	159,091,563
Total pension liability, ending (a)	189,631,184	187,270,165	176,783,358	171,918,210
<b>Fiduciary net position:</b>				
Employer contributions	5,256,900	9,600,000	4,500,000	4,093,996
Investment income, net of investment expenses	12,377,573	14,220,462	1,740,670	7,786,180
Benefit payments	(10,084,820)	(9,858,352)	(9,552,117)	(9,590,546)
Administrative expenses	(255,300)	(279,696)	(234,464)	(248,932)
Net change in fiduciary net position	7,294,353	13,682,414	(3,545,911)	2,040,698
Fiduciary net position, beginning	176,993,428	163,311,014	166,856,925	164,816,227
Fiduciary net position, ending (b)	184,287,781	176,993,428	163,311,014	166,856,925
Net pension liability ending = (a) - (b)	5,343,403	10,276,737	13,472,344	5,061,285
Fiduciary net position as a % of total pension liability	97.18%	94.51%	92.38%	97.06%
Covered payroll	29,960,300	30,210,365	30,412,207	31,376,937
Net pension liability as a % of covered payroll	17.83%	34.02%	44.30%	16.13%

Per GASB 67, until a 10-year trend is compiled, pension plans may present information for those years for which information is available; information is not available under the GASB 67 methodologies for the fiscal years prior to 2014.

**Port of Houston Authority Restated Retirement Plan**

SCHEDULE OF PORT AUTHORITY CONTRIBUTIONS  
Last Ten Fiscal Years

	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Actuarially determined contribution	\$ 5,006,628	\$ 5,152,984	\$ 4,480,580	\$ 4,093,996	\$ 5,278,440	\$ 9,870,470	\$ 8,132,756	\$ 10,808,796	\$ 9,857,308	\$ 7,357,368
Contributions in relation to the actuarially determined contribution	<u>5,256,900</u>	<u>9,600,000</u>	<u>4,500,000</u>	<u>4,093,996</u>	<u>8,281,695</u>	<u>9,870,470</u>	<u>8,132,756</u>	<u>10,808,796</u>	<u>9,857,308</u>	<u>7,357,368</u>
Contribution deficiency (excess)	<u>\$ (250,272)</u>	<u>\$ (4,447,016)</u>	<u>\$ (19,420)</u>	<u>\$ -</u>	<u>\$ (3,003,255)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered payroll	\$ 29,960,300	\$ 30,210,365	\$ 30,412,207	\$ 31,376,937	\$ 33,689,999	\$ 35,081,902	\$ 35,570,719	\$ 34,938,502	\$ 32,695,393	\$ 32,270,226
Contributions as a percentage of covered employee payroll	17.55%	31.78%	14.80%	13.05%	24.58%	28.14%	22.86%	30.94%	30.15%	22.80%

**Notes to Schedule**

Valuation timing	Actuarially determined contribution rates are calculated as of July 31 of the fiscal year in which the contributions are reported.
Actuarial cost method	Entry Age Normal
Amortization method	Level dollar
Remaining amortization period	1 year at July 31, 2018, resulting from a net pension liability of \$5,343,403
Asset valuation method	Market value
Inflation	2.50%
Salary increases	Graded from 7.5% at age 20 to 3.0% at age 60
Investment rate of return	6.75%
Cost of living adjustments	None
Retirement age	Ranging from 5% at age 55 to 100% at age 70
Turnover	Rates from most recent assumption study performed August 1, 2015
Mortality	RP-2016 Mortality for Employees, Healthy Annuitants and Disabled Annuitants with generational projection per MP-2016



**Port of Houston Authority Restated Retirement Plan**

**SCHEDULE OF INVESTMENT RETURNS**  
Last Four Fiscal Years

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Annual money-weighted rate of return net of investment expenses	5.60%	8.40%	-0.65%	3.04%

Per GASB 67, until a 10-year trend is compiled, pension plans may present information for those years for which information is available; information is not available under the GASB 67 methodologies for the fiscal years prior to 2014.

**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT*  
AUDITING STANDARDS**

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Port Commission of the Port of Houston Authority of Harris County, Texas  
Pension and Benefits Committee  
Port of Houston Authority Restated Retirement Plan

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Port of Houston Authority Restated Retirement Plan (the “Plan”), which comprise the statements of fiduciary net position as of July 31, 2018 and 2017, and the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated January 23, 2019.

**Internal control over financial reporting**

In planning and performing our audit of the financial statements, we considered the Plan’s internal control over financial reporting (“internal control”) to design audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express an opinion on the effectiveness of the Plan’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Plan’s financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in the Plan's internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

#### Compliance and other matters

As part of obtaining reasonable assurance about whether the Plan's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

#### Intended purpose

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Plan's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Plan's internal control and compliance. Accordingly, this report is not suitable for any other purpose.



Houston, Texas  
January 23, 2019