

Financial Statements and Report of
Independent Certified Public
Accountants

**Port of Houston Authority
Restated Retirement Plan**

July 31, 2019 and 2018

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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, 2019 and 2018, 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, 2019 and 2018, 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 basic 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 27, 2020, 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 27, 2020

Port of Houston Authority Restated Retirement Plan

MANAGEMENT'S DISCUSSION AND ANALYSIS

**July 31, 2019 and 2018
(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, 2019 and 2018.

Financial highlights

The net position restricted for pensions (the "net position") of the Plan at July 31, 2019, 2018, and 2017 was \$184,407,686, \$184,287,781, and \$176,993,428, 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, 2019.

The Plan's net position increased by \$119,905 and \$7,294,353 between fiscal years 2019 and 2018. ("FY2019", "FY2018"). The increase in net position for both FY2019 and FY2018 was attributed to unrealized gains on Plan investments.

The Plan investments had a net appreciation in fair value of \$827,774, \$7,669,429, and 9,863,761 for FY2019, FY2018, and FY2017, respectively. The net increase in fair value was primarily due to realized and unrealized gains during each year including other earnings from interest-bearing securities.

Additions to the Plan are made primarily through contributions from the Authority. These contributions totaled \$4,658,000, \$5,256,900, and \$9,600,000, for the years ended July 31, 2019, 2018, and 2017, respectively. The decrease in 2018 is due primarily to additional funding of \$4,000,000 authorized in 2017 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 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, 2019, 2018, and 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Asset allocation:			
Domestic and foreign equities	47%	49%	48%
Fixed income investments	44	42	42
Master limited partnerships	7	8	8
Cash and cash equivalents	2	1	2

Benefit payments are the primary expense of the Plan. Such payments totaled \$10,326,046, \$10,084,820, and \$9,858,352, for the years ended July 31, 2019, 2018, and 2017, respectively. Benefit payments across all periods remained at a reasonable level. Other expenses of the Plan include administrative expenses, which totaled \$243,143, \$255,300, and \$279,696, for the years ended July 31, 2019, 2018, and 2017, 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.

Port of Houston Authority Restated Retirement Plan

MANAGEMENT'S DISCUSSION AND ANALYSIS

**July 31, 2019 and 2018
(Unaudited)**

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.

Statements of Fiduciary Net Position

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Assets:			
Cash and cash equivalents	\$ 2,730,045	\$ 2,695,860	\$ 3,700,267
Investments	181,121,789	180,807,927	172,611,929
Accrued investment income	<u>612,324</u>	<u>839,852</u>	<u>734,430</u>
Total assets	184,464,158	184,343,639	177,046,626
Liabilities:			
Accrued administrative and investment expenses	<u>56,472</u>	<u>55,858</u>	<u>53,198</u>
Total liabilities	<u>56,472</u>	<u>55,858</u>	<u>53,198</u>
Net position restricted for pensions	<u>\$ 184,407,686</u>	<u>\$ 184,287,781</u>	<u>\$ 176,993,428</u>

Condensed Statements of Changes in Plan Net Assets

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Additions:			
Contributions	\$ 4,658,000	\$ 5,256,900	\$ 9,600,000
Net investment income	<u>6,031,094</u>	<u>12,377,573</u>	<u>14,220,462</u>
Total additions	10,689,094	17,634,473	23,820,462
Deductions:			
Benefit payments	10,326,046	10,084,820	9,858,352
Administrative expenses	<u>243,143</u>	<u>255,300</u>	<u>279,696</u>
Total deductions	<u>10,569,189</u>	<u>10,340,120</u>	<u>10,138,048</u>
Net increase (decrease) in net position	119,905	7,294,353	13,682,414
Net position restricted for pensions			
Beginning of year	<u>184,287,781</u>	<u>176,993,428</u>	<u>163,311,014</u>
End of year	<u>\$ 184,407,686</u>	<u>\$ 184,287,781</u>	<u>\$ 176,993,428</u>

Port of Houston Authority Restated Retirement Plan

MANAGEMENT'S DISCUSSION AND ANALYSIS

**July 31, 2019 and 2018
(Unaudited)**

Requests for Information

The financial report is designed to provide an overview of the Plan's finances for those with an interest in the Authority's pension related activities. 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,

	<u>2019</u>	<u>2018</u>
Assets:		
Cash and cash equivalents	\$ 2,730,045	\$ 2,695,860
Investments	181,121,789	180,807,927
Accrued investment income	<u>612,324</u>	<u>839,852</u>
Total assets	184,464,158	184,343,639
Liabilities:		
Accrued administrative and investment expenses	<u>56,472</u>	<u>55,858</u>
Total liabilities	<u>56,472</u>	<u>55,858</u>
Net position restricted for pensions	<u>\$ 184,407,686</u>	<u>\$ 184,287,781</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

Years ended December 31,

	2019	2018
Additions:		
Employer contributions	\$ 4,658,000	\$ 5,256,900
Investment income:		
Net appreciation in fair value	827,774	7,669,429
Interest	3,271,974	2,835,728
Dividends	2,594,056	2,533,265
Other	260	823
Total investment income	6,694,064	13,039,245
Investment expenses	(662,970)	(661,672)
Net investment income	6,031,094	12,377,573
Total additions	10,689,094	17,634,473
Deductions:		
Retirement benefits	10,326,046	10,084,820
Administrative expenses	243,143	255,300
Total deductions	10,569,189	10,340,120
Net increase in net position	119,905	7,294,353
Net position restricted for pensions		
Beginning of year	184,287,781	176,993,428
End of year	\$ 184,407,686	\$ 184,287,781

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

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS

July 31, 2019 and 2018

The following brief description of 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. BBVA USA (formerly known as Compass Bank) served as of July 31, 2019 as the trustee of the Plan.

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

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 at the date of the financial statements. Actual results could differ from these estimates.

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.

Cash and Cash Equivalents

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

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

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.

Administrative and Investment Expenses

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

Payment of Benefits

Cash payments to participants for benefits are recorded upon distribution.

NOTE B - PLAN DESCRIPTION

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. The Authority made contributions of \$4,658,000 and \$5,256,900 for fiscal years 2019 and 2018, respectively.

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.

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.

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.

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

Plan Membership

The number of plan members consisted of the following at August 1, 2019 and 2018, the date of the two latest actuarial valuations:

	<u>2019</u>	<u>2018</u>
Retirees and beneficiaries receiving payments	546	529
Terminated vested participants not yet receiving benefits	170	178
Disabled participants	5	10
Active participants	<u>340</u>	<u>355</u>
 Total	 <u>1,061</u>	 <u>1,072</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 last amended on September 25, 2018 to clarify that staff is authorized to rebalance the portfolio in accordance with asset allocation guidelines approved by the Commission, and that sufficient assets may be maintained in money market accounts and other cash equivalents to cover expenses and monthly benefit payment requirements. The policy also stipulates that investment manager performance should be reviewed over three-, five- and ten-year periods. A copy of the investment policy is available on the Authority's website (www.porthouston.com).

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:

<u>Asset class</u>	<u>Minimum</u>	<u>Target</u>	<u>Maximum</u>
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		 <u>100.0%</u>	

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

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, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Fixed income investments	\$ 81,050,992	\$ 79,544,745
Money market funds	2,730,045	2,695,860
Equity investments:		
Domestic	84,925,978	97,544,653
International	<u>15,144,819</u>	<u>3,718,529</u>
Total equity investments	100,070,797	101,263,182
Total	<u>\$ 183,851,834</u>	<u>\$ 183,503,787</u>

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 BBVA USA 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, 2019 and 2018 (including realized gains on investments) depreciated/appreciated in total value as follows:

	<u>2019</u>	<u>2018</u>
Fixed income investments	\$ 2,697,459	\$ (2,960,054)
Equity investments	<u>(1,869,685)</u>	<u>10,629,483</u>
Total	<u>\$ 827,774</u>	<u>\$ 7,669,429</u>

During the fiscal years ended July 31, 2019 and 2018, interest and dividends earned and other income on the Plan's investments amounted to \$5,866,290 and \$5,369,816, respectively.

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

As of July 31, 2019, and 2018, the Plan had the following investments in its fixed income accounts:

Investment type	2019		2018	
	Fair value	Percentage of total	Fair value	Percentage of total
U.S. treasuries	\$ 9,399,968	11.60%	\$ 11,834,857	15.40%
U.S. government agencies	20,042,248	24.73	12,904,838	16.80
Corporate obligations	36,716,496	45.30	42,203,935	54.93
Mutual fund	9,544,689	11.77	9,348,579	12.17
International fixed income	4,253,004	5.25	-	-
Municipal obligations	1,094,587	1.35	542,207	0.70
	<u>\$ 81,050,992</u>	<u>100.00%</u>	<u>\$ 76,834,416</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.

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.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of investments in a single issuer. The Plan's investment policy limits the amount that may be invested in any one issuer.

As of July 31, 2019 and 2018, the Plan had the following investments in excess of 5% of total investments:

	2019	2018
Vanguard Inst Index (Cusip 922040100)	\$ 14,390,715	\$ 14,170,794
Causeway International Value-Institutional (Cusip 14949P208)	11,675,971	12,934,360
Cohen & Steers Institutional Realty Shares (Cusip 19247U106)	11,606,335	9,965,925
Loomis Sayles Institutional High Income (Cusip 543495600)	9,544,689	9,348,579
Total	<u>\$ 47,217,710</u>	<u>\$ 46,419,658</u>

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

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%.

The following table details the U.S. dollar bond holdings and their duration by fund manager as of July 31, 2019 and 2018:

	Smith Graham		MacKay Shields, LLC	
	Fair value	Duration in years	Fair value	Duration in years
<u>2019</u>				
U.S. treasuries	\$ 3,137,280	16.40	\$ 6,262,688	14.07
U.S. government agencies	7,061,440	3.80	12,980,808	3.22
Corporate obligations	19,512,265	5.38	17,204,231	5.02
Municipal obligations	1,094,587	6.65	-	-
International fixed income	1,343,395	5.61	2,909,609	4.84
Total fair value	\$ 32,148,967		\$ 39,357,336	
Portfolio average duration		6.48		5.84
<u>2018</u>				
U.S. treasuries	\$ 4,532,858	9.35	\$ 7,301,999	8.87
U.S. government agencies	6,117,712	5.17	6,787,126	5.28
Corporate obligations	22,639,647	4.97	19,564,288	5.07
Municipal obligations	542,207	7.37	-	-
Total fair value	\$ 33,832,424		\$ 33,653,413	
Portfolio average duration		5.63		5.94

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, the ADRs 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 \$19,397,823 and \$18,527,745 through its investments in international mutual funds, international equities and international fixed income securities as of July 31, 2019 and 2018, respectively.

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

Annual Money-Weighted Rate of Return

For the year ended July 31, 2019, the annual money-weighted rate of return on Plan investments, net of investment expense, was 1.30%. The money-weighted rate of return expresses investment performance, net of investment expenses, adjusted for the changing amounts actually invested.

Fair Value of Investments

The Plan has estimated the fair value of financial instruments in accordance with the fair value guidance provided in accordance with GASB 72 - *Fair Value Measurement and Application*. This statement provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. 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 due to 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, 2019 and 2018 and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

<u>2019</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Domestic equity	\$ 46,602,230	\$ -	\$ 46,602,230
International equity	2,677,898	-	2,677,898
Mutual funds	47,217,710	-	47,217,710
U.S. treasuries	9,399,968	-	9,399,968
U.S. corporate obligations	-	36,716,496	36,716,496
Municipal obligations	-	1,094,587	1,094,587
U.S. government agencies	-	20,042,248	20,042,248
International fixed income	-	4,253,004	4,253,004
Master limited partnerships	13,117,648	-	13,117,648
	<hr/>	<hr/>	<hr/>
Total	<u>\$ 119,015,454</u>	<u>\$ 62,106,335</u>	<u>\$ 181,121,789</u>

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

<u>2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Domestic equity	\$ 60,939,448	\$ -	\$ 60,939,448
International equity	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
	<hr/>	<hr/>	<hr/>
Total	\$ 122,446,618	\$ 58,361,309	\$ 180,807,927

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>2019</u>	<u>2018</u>
Total pension liability	\$ 197,409,371	\$ 189,631,184
Fiduciary net position	184,407,686	184,287,781
Net pension liability	13,001,685	5,343,403
Fiduciary net position as a % of total pension liability	93.41%	97.18%
Covered payroll	29,889,386	29,960,300
Net pension liability as a % of covered payroll	43.50%	17.83%

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

Actuarial Assumptions

The total pension liability was determined by an actuarial valuation as of August 1, 2018 and rolled forward to the measurement date of July 31, 2019, 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.

	2019	2018
Valuation date	August 1, 2018	August 1, 2017
Measurement date	July 31, 2019	July 31, 2018
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	6.50%	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-2006 Mortality for Employees, Healthy Annuitants, and Disabled Annuitants with generational projection per MP-2018	RP-2006 Mortality for Employees, Healthy Annuitants, and Disabled Annuitants with generational projection per MP-2016

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 FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

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, 2019 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	Merrill Lynch High Yield Master II Constrained	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%
International Equity	MSCI EAFE	7.5%	8.5%
Real Estate (REITs)	FTSE NAREIT All REITS Total Return	5.0%	4.5%
Master Limited Partnership	Alerian MLP	10.0%	7.5%
Long-term expected (weighted) rate of return:			5.17%

Actuarial assumed long-term investment rate of return or discount rate: 6.50%

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

Discount Rate

The discount rate used to measure the total pension liability was 6.50%. 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 6.50% on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

	<u>July 31, 2019</u>	<u>July 31, 2018</u>
Discount rate	6.50%	6.75%
Long-term expected rate of return, net of investment expense	6.50%	6.75%
Municipal bond rate	N/A	N/A

Port of Houston Authority Restated Retirement Plan

NOTES TO FINANCIAL STATEMENTS - CONTINUED

July 31, 2019 and 2018

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 6.50%, as well as what the Authority's net pension liability would be if it were calculated using a discount rate that is 1% lower (5.50%) or 1% higher (7.50%) than the current rate:

	1% decrease 5.50%	Current discount rate 6.50%	1% increase 7.50%
Net pension liability (asset)	36,003,953	13,001,685	(6,405,668)

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 Six Fiscal Years

	<u>July 31, 2019</u>	<u>July 31, 2018</u>	<u>July 31, 2017</u>	<u>July 31, 2016</u>	<u>July 31, 2015</u>	<u>July 31, 2014</u>
Total pension liability:						
Service cost	\$ 3,320,773	\$ 3,402,422	\$ 3,198,269	\$ 3,228,805	\$ 3,186,018	\$ 3,425,775
Interest on total pension liability	12,591,994	12,454,101	12,251,337	11,883,003	10,939,999	10,724,158
Effect of economic/demographic (losses)	(1,325,175)	(1,207,309)	(116,722)	(694,543)	(1,277,703)	-
Effect of assumption changes or inputs	3,516,641	(2,203,375)	5,012,275	-	9,568,882	-
Benefit payments	(10,326,046)	(10,084,820)	(9,858,352)	(9,552,117)	(9,590,546)	(9,508,901)
Net change in total pension liability	7,778,187	2,361,019	10,486,807	4,865,148	12,826,647	4,641,033
Total pension liability, beginning	189,631,184	187,270,165	176,783,358	171,918,210	159,091,563	154,450,530
Total pension liability, ending (a)	197,409,371	189,631,184	187,270,165	176,783,358	171,918,210	159,091,563
Fiduciary net position:						
Employer contributions	4,658,000	5,256,900	9,600,000	4,500,000	4,093,996	8,281,695
Investment income, net of investment expenses	6,031,094	12,377,573	14,220,462	1,740,670	7,786,180	14,825,222
Benefit payments	(10,326,046)	(10,084,820)	(9,858,352)	(9,552,117)	(9,590,546)	(9,508,901)
Administrative expenses	(243,143)	(255,300)	(279,696)	(234,464)	(248,932)	(236,560)
Net change in fiduciary net position	119,905	7,294,353	13,682,414	(3,545,911)	2,040,698	13,361,456
Fiduciary net position, beginning	184,287,781	176,993,428	163,311,014	166,856,925	164,816,227	151,454,771
Fiduciary net position, ending (b)	184,407,686	184,287,781	176,993,428	163,311,014	166,856,925	164,816,227
Net pension liability ending = (a) - (b)	13,001,685	5,343,403	10,276,737	13,472,344	5,061,285	(5,724,664)
Fiduciary net position as a % of total pension liability	93.41%	97.18%	94.51%	92.38%	97.06%	103.60%
Covered payroll	29,889,386	29,960,300	30,210,365	30,412,207	31,376,937	33,689,999
Net pension liability as a % of covered payroll	43.50%	17.83%	34.02%	44.30%	16.13%	(16.99%)

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

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Actuarially determined contribution	\$ 4,436,764	\$ 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
Contributions in relation to the actuarially determined contribution	<u>4,658,000</u>	<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>
Contribution deficiency (excess)	<u>\$ (221,236)</u>	<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>
Covered payroll	\$ 29,889,386	\$ 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
Contributions as a percentage of covered employee payroll	15.58%	17.55%	31.78%	14.80%	13.05%	24.58%	28.14%	22.86%	30.94%	30.15%

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	One year at July 31, 2019, resulting from a net pension liability of \$13,001,685
Asset valuation method	Market value
Inflation	0.025
Salary increases	Graded from 7.5% at age 20 to 3.0% at age 60
Investment rate of return	0.065
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-2006 Mortality for Employees, Healthy Annuitants and Disabled Annuitants with generational projection per MP-2018

Port of Houston Authority Restated Retirement Plan

SCHEDULE OF INVESTMENT RETURNS

Last Six Fiscal Years

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Annual money-weighted rate of return net of investment expenses	1.30%	5.60%	8.40%	-0.65%	3.04%	9.51%

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.

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

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, 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, 2019 and 2018, 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 27, 2020.

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.

Grant Thornton LLP

Houston, Texas
January 27, 2020