OFFICE OF THE HOUSTON CITY CONTROLLER

TRENDS REPORT

FISCAL YEAR 2025

CHRIS HOLLINS | CITY CONTROLLER

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To:	Council Member Sallie Alcorn, Chair, Budget and Fiscal Affairs Committee	**From:**	Chris Hollins, City Controller
Cc:	Mayor John Whitmire Members of City Council	**Date:**	May 20, 2024
		Subject:	Trends for Fiscal Year 2025

Madame Chair:

Each year, my Office diligently provides a trends report to assist City Council in contextualizing the Administration's fiscal year proposed budget. This report offers council members a comprehensive financial analysis, enabling informed decision-making and ensuring a broader perspective on our city's financial landscape. The report places significant emphasis on General Fund revenue projections, adopting a conservative approach that encapsulates our most reliable estimates.

ECONOMIC OUTLOOK

Over the past year, the national economy has displayed resilience and is showing signs of returning to a sense of normalcy following the challenges of COVID-19. We've witnessed a decline in inflation alongside a robust labor market. However, the real estate sectors, both residential and commercial, have experienced cooling effects due to interest rate hikes, reaching 20-year highs. The recent forecast from the Greater Houston Partnership suggests that employment growth may be slower in 2024.

Although oil prices have maintained relative stability, fluctuating between $70 to $89 per barrel over the past 12 months, we must remain vigilant regarding potential financial implications stemming from global unrest. It's imperative that we continue to monitor these economic indicators closely to navigate any forthcoming challenges.

A LOOK BACK

As reported in the March Quarterly Financial Report for the General Fund, our office is projecting that the City will conclude FY2024 with a fund balance of $453.8 million, which constitutes 18.3% of expenditures less debt service and pay-as-you-go (PAYGO). Based on current projections, this fund balance will exceed the City’s target holding of 7.5 percent of expenditures less debt service and PAYGO by approximately $267.5 million.

This significant fund balance is attributable to various factors, including the assistance of $160 million in one-time federal funding and stronger than expected sales tax revenues. It stands as one of the largest fund balances in the City’s history. However, it's essential to reiterate that this fund balance offers only a temporary reprieve in addressing the deep-seated structural imbalances within our budget, as I have previously communicated to Council.

THE DEFICIT

The City of Houston's expenses continue to rise while revenue decreases, and the situation is becoming critical. With a structural deficit of $200 million and growing, we are in an unsustainable position and in need of real solutions. Like budgets before it, the proposed FY2025 Budget is balanced mainly through one-time funding. These sources include a fund balance drawdown of $187.1 million and ARPA funding of $10 million (noting that last year's budget relied on $160 million from ARPA funds). Additionally, the budget incorporates $11.7 million in departmental reductions.

Although this budget achieves balance, it's essential to recognize that it still harbors a structural imbalance, wherein recurring revenues fail to match recurring expenses. Addressing this structural imbalance is imperative for the long-term fiscal health and sustainability of our city.

LOWER REVENUES, HIGHER EXPENSES

Revenue

Our revenue estimates for FY2025 amount to $2.8 billion, reflecting a decrease of 3.4% compared to the FY2024 estimate. The most significant change in revenue is a decrease in the Intergovernmental category of $147.5 million primarily due to ARPA funding.

The largest revenue source is property tax, with an FY2025 Estimate of $1.4 billion, reflecting an increase of $44.5 million compared to FY2024. This estimate is calculated using the Proposition 1 and Proposition H calculation method, which incorporates an inflation rate of 3.5% and population growth of 0%.

The second largest revenue source is Sales tax, with an FY2025 Estimate of $886 million, representing an increase of $5 million compared to the FY2024 Estimate. This projection is grounded in our conservative approach, utilizing a model that considers various economic indicators such as employment, oil prices, and inflation.

As previously communicated to Council, my office will provide three potential outcomes for sales tax, including a conservative ($886 million), a base scenario ($920 million), and an optimistic scenario ($939 million). Given its volatility and sensitivity to market trends, we will closely monitor sales tax revenue throughout the year and make necessary adjustments as needed.

Expenses

The estimate for expenses is derived solely from the Mayor's FY2025 Proposed Budget. Expenses for FY2025 amount to $3.0 billion, reflecting an increase of 2.5% compared to the FY2024 Estimate of $2.9 billion. FY2025 Budget includes 3.5% pay increases for police under the existing Meet and Confer Agreement, expiring June 30, 2025.

Of the total General Fund expenses, Police and Fire alone account for $1.7 billion (with Police at $1.0 billion and Fire at $0.6 million), constituting 55.4% of the overall expenses. The remaining 21 departments comprise $0.8 million or 27.6%, while debt represents $0.5 million or 17.0%.

On March 14, 2024, the Mayor announced a proposed settlement with Houston Professional Fire Fighters Association Local 341 to resolve longstanding litigation regarding backpay and establish a collective bargaining agreement through FY2029. The settlement includes:

- $650 million for 7 years of backpay (FY2018-24).
- A 10% raise in FY2025, with raises of up to 6% annually over the subsequent 4 years.

This budget includes $30.6 million for the first-year debt service payment related to the restructuring bond for backpay, 10% pay raise, effective from the first full pay period beginning July, and an increase of $10 million for assignment and educational pay.

The FY2025 Budget will continue to fund long-term liabilities including pension and Other Post Employment Benefits (OPEB). The FY2025 Budget will continue to fund OPEB trust contribution of $12.5 million an increase of $2.5 million compared to FY2024.

Additionally, $11.7 million in reduction is included to capture departmental cost savings and efficiencies.

FUND BALANCE

Based on our revenue estimates and the Mayor's projected expenses, we anticipate an ending fund balance of $247.9 million, which equates to 9.8% of expenditures less debt services and PAYGO. This amount exceeds the City's target holding of 7.5 percent of expenditures less debt service and PAYGO by $59.1 million. However, compared to the FY2024 estimated fund balance, this signifies a notable reduction. Looking forward to FY2026, the robust fund balances witnessed in recent fiscal years will gradually regress to pre-COVID levels as the one-time federal funding diminishes.

THE NEED FOR LONG-TERM FINANCIAL PLANNING

One thing remains evident: we are currently on an unsustainable path. Without implementing structural changes, such as a substantial increase in recurring revenue or a reduction in recurring expenses, the City will inevitably confront difficult decisions regarding the level of service we can sustainably provide. We must address these challenges proactively to ensure the long-term financial health and viability of our city.

Presently, we benefit from the security provided by historically high fund balance levels. However, in a year's time, the situation will shift significantly. Instead of relying on temporary solutions, genuine structural alterations will be necessary. My office is committed to working with the Mayor and members of City Council to help bring about those changes.

ACCOUNTABILITY – TRANSPARENCY - INNOVATION

It's imperative that we prioritize accountability, transparency, and innovation in our budget process to foster confidence among the citizens we serve. By holding ourselves accountable for fiscal decisions, ensuring transparency in budgetary matters, and embracing innovative approaches, we can build trust and credibility with our community. As stewards of public funds, we owe it to our citizens to uphold the highest standards of financial responsibility and governance. Through collaborative efforts and a steadfast commitment to these principles, we can navigate the fiscal challenges ahead and pave the way for a brighter future for our city.

ENTERPRISE FUNDS

In Enterprise Funds, Aviation revenues are increasing due to an anticipated increase in signatory landing, terminal space rentals and garage parking revenue. Convention & Entertainment revenues are expected to be higher due to increased collections of Hotel Occupancy Tax (HOT) and parking fees. The Combined Utility System's revenues are expected to increase, primarily due to an increase in water and sewer rates and inflation adjustments.

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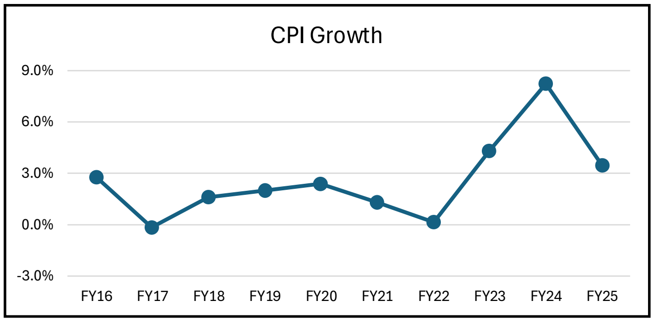
NOTES ON GRAPHS

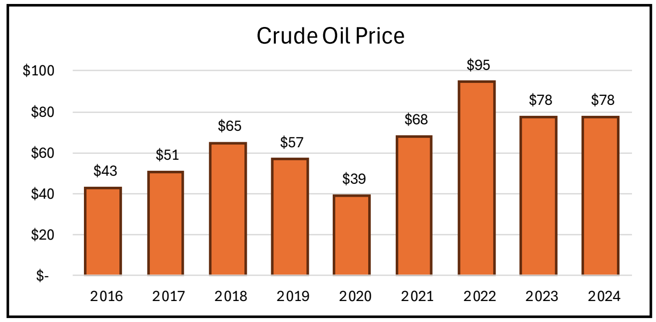
The numbers on each page are from the following sources:

1. FY2023 and prior years are actual results as reported in the issued Annual Comprehensive Financial Reports.
2. FY2024 estimates are from the Controller's Office March FY2024 Monthly Financial Report.
3. The FY2025 General Fund revenues are the most current projections of the Controller's Office.
4. Unless otherwise noted, all other FY2025 numbers are from the Mayor's FY2025 Proposed Budget.

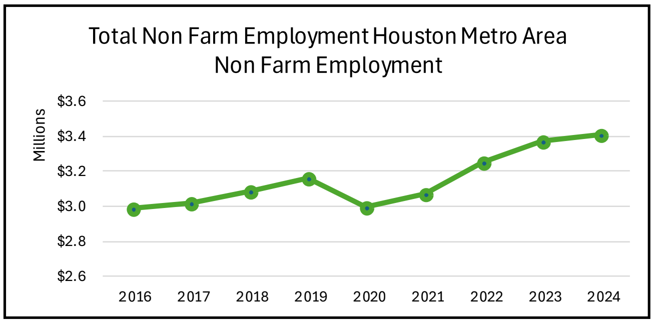
ECONOMIC OUTLOOK



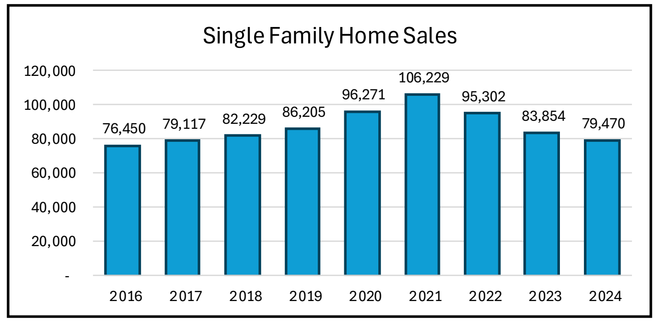
Source: U.S. Bureau of Labor Statistics



Source: U.S. Energy Information Administration - WTI



Source: Texas Workforce Commission



Source: Houston Association of REALTORS

The Houston economy has demonstrated remarkable resilience in its recovery from the COVID-19 pandemic, but there are signs of a return to pre-pandemic trends. Here's an overview:

Inflation:

Projections suggest that inflation will continue its downward trajectory in FY25, expected to reach 3.5%. This contrasts with the previous peak of 8.2% recorded in FY2024.

Jobs:

Although the Houston job market remains robust, the latest forecasts from the Greater Houston Partnership indicate a potential slowdown in employment growth for 2024.

Price of Oil:

Oil prices have exhibited relative stability, fluctuating between $70 and $89 per barrel over the past 12 months.

Home Sales:

According to the Houston Association of Realtors (HAR), while there was significant growth in housing inventory and a moderation in pricing during 2023, the surge in mortgage interest rates to 20-year highs led many prospective buyers to postpone purchasing plans or shift towards rental housing. As 2024 commences, Houston's residential housing market is seen as stable, although uncertainties persist regarding potential actions by the Federal Reserve on interest rates and lingering consumer concerns about inflation.

GENERAL FUND REVENUES

(Amount expressed in thousands)

Revenues	FY2021 Actual	FY2022 Actual	FY2023 Actual	FY2024 Controller's March Proj.	FY2025 Controller's Projection	Controller's % Change [a]	Admin's Proposed Budget	$ Difference [a]
General Property Tax	1,254,016	1,244,722	1,295,496	1,376,663	1,421,173	3.2% [b]	1,421,173	—
Industrial Assessments	25,435	24,086	28,021	24,000	25,281	5.3%	27,277	(1,996)
Sales Tax	706,829	820,622	889,039	880,772	886,000	0.6% [c]	893,382	(7,382)
Other Taxes	14,561	21,585	23,607	23,800	23,800	0.0%	24,896	(1,096)
Electric Franchise	98,834	95,801	95,728	98,000	98,388	0.4%	100,445	(2,057)
Telephone Franchise	21,576	19,481	18,203	16,000	15,000	-6.3%	14,860	140
Gas Franchise	13,034	13,084	13,048	14,000	14,000	0.0%	16,210	(2,210)
Other Franchise	20,157	21,153	21,180	19,000	19,000	0.0%	19,030	(30)
License & Permits	31,386	32,988	33,673	33,682	33,682	0.0%	33,736	(54)
Intergovernmental	67,258	200,714	208,176	197,776	50,200	-74.6% [d]	50,248	—
Charges for Services	65,698	75,292	76,166	78,250	81,200	3.8%	81,309	(109)
Direct Interfund Services	59,308	60,475	65,845	69,867	75,061	7.4% [e]	75,061	—
Indirect Interfund Services	24,688	25,235	22,801	26,079	24,871	-4.6%	24,871	—
Municipal Courts Fines & Forfeits	14,993	16,752	17,318	16,000	16,500	3.1%	17,063	(563)
Other Fines & Forfeits	3,023	3,434	3,371	3,000	3,000	0.0%	3,043	(43)
Interest	5,133	4,659	12,518	17,800	19,400	9.0%	20,993	(1,593)
Miscellaneous/Other	13,290	15,711	15,913	12,100	12,100	0.0%	13,209	(1,109)
Total Revenues	**2,439,219**	**2,695,794**	**2,840,103**	**2,906,789**	**2,818,656**	**-3.0%**	**2,836,807**	**(18,150)**
Other Resources								
Transfers from other funds	6,031	8,562	10,044	10,834	7,781	-28.2% [f]	7,781	—
Sale of Capital Assets	2,543	3,747	2,773	11,160	2,752	-75.3% [g]	2,752	—
Total Revenues and Other Resources	**2,447,793**	**2,708,103**	**2,852,920**	**2,928,783**	**2,829,189**	**-3.4%**	**2,847,340**	**(18,151)**

[a] The “Percentage Change” column compares our Fiscal Year 2025 projection to our Fiscal Year 2024 estimate, while the “Difference” column compares our Fiscal Year 2025 projection to the Administration’s proposed budget.

[b] Property Tax revenue is calculated according to Proposition 1 and Proposition H, which incorporates an inflation rate of 3.5% and a projected population growth of 0%. Property Tax revenue is expected to increase by $44.5 million or 3.2%.

[c] Sales Tax revenue projection is based on our conservative output from the sales tax econometric model factoring in various indicators such as employment, oil prices, and inflation. Sales tax revenue is expected to increase by $5.3 million or 0.6%.

[d] Intergovernmental decreased primarily due to the utilization ARPA funding to address the reduction of revenues due to the COVID-19 public health emergency.

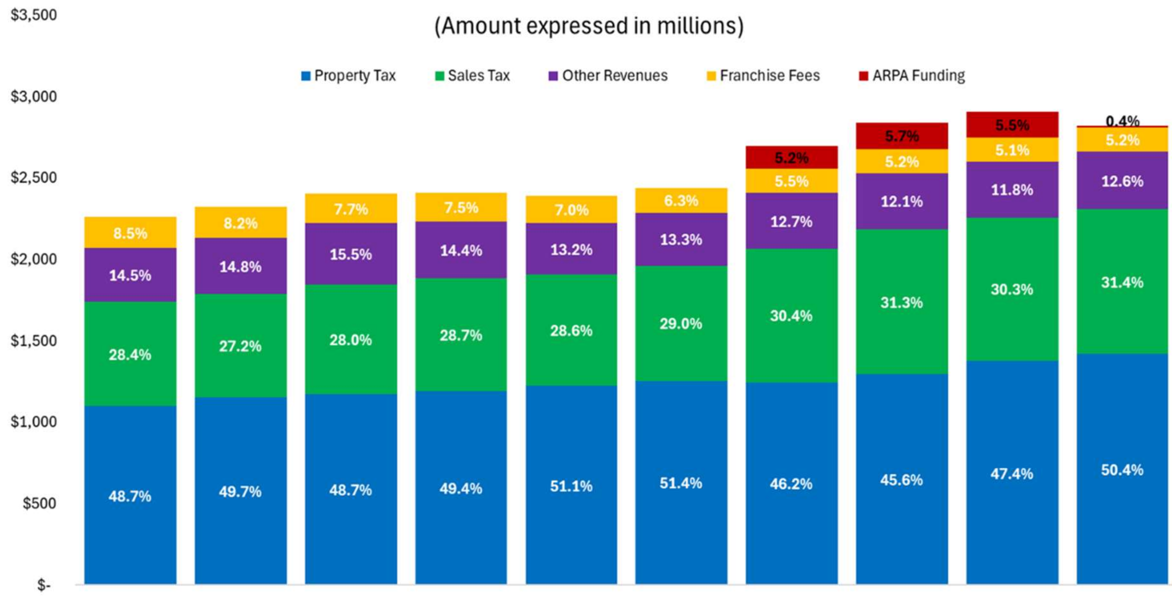
[e] Direct Interfund Services are expected to increase by $5.2 million, or 7.4%, due to fire and police protection services provided to the Houston Airport System.

[f] Transfer from other Funds is expected to decrease by $3.0 million, or 28.2%, primarily due to lower transfer from ParkHouston Special Revenue Fund.

[g] Sale of Capital Assets are expected to decrease by $8.4 million, or 75.3%, due one-time land sale transactions in FY2024.

GENERAL FUND REVENUES

(Amount expressed in millions)



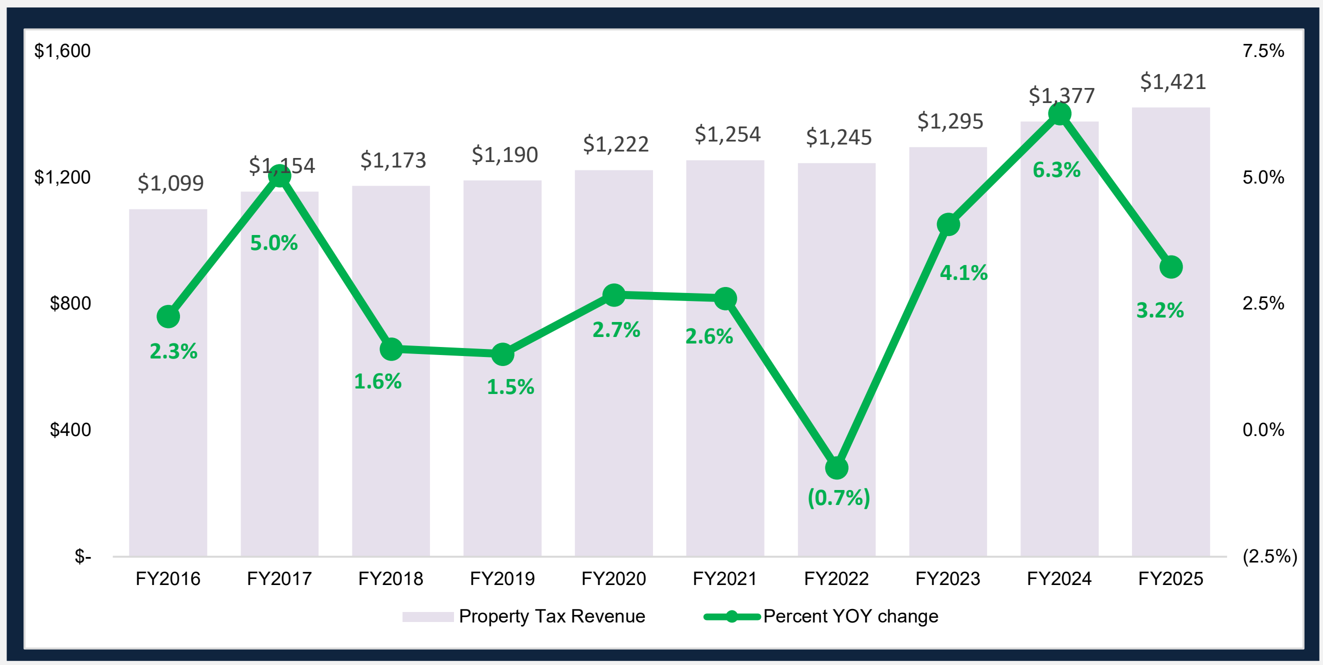
Category	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Property Tax	$ 1,099	$ 1,154	$ 1,173	$ 1,190	$ 1,222	$ 1,254	$ 1,245	$ 1,295	$ 1,377	$ 1,421
Sales Tax	640	632	674	692	684	707	821	889	881	886
Franchise Fees	191	191	186	180	168	154	150	148	147	146
ARPA Funding	-	-	-	-	-	-	139	163	160	10
Other Revenues	328	344	373	347	316	325	341	345	342	355
Total Revenues	**$ 2,258**	**$ 2,321**	**$ 2,406**	**$ 2,410**	**$ 2,390**	**$ 2,439**	**$ 2,696**	**$ 2,840**	**$ 2,907**	**$ 2,819**
Dollar YOY change	*45*	*62*	*85*	*4*	*(19)*	*49*	*257*	*144*	*67*	*(88)*
Percent YOY change	*2.0%*	*2.8%*	*3.7%*	*0.2%*	*-0.8%*	*2.0%*	*10.5%*	*5.4%*	*2.3%*	*-3.0%*

Fiscal Year 2025 General Fund revenues excluding other resources are projected to decrease by $87.9 million, or 3.0% below our current Fiscal Year 2024 estimate.

The most significant change in revenue is a decrease of $150 million in ARPA funding, offset with increases in Property Tax, Sales Tax and Other Revenues such as interfund services, interest, and ambulance fees.

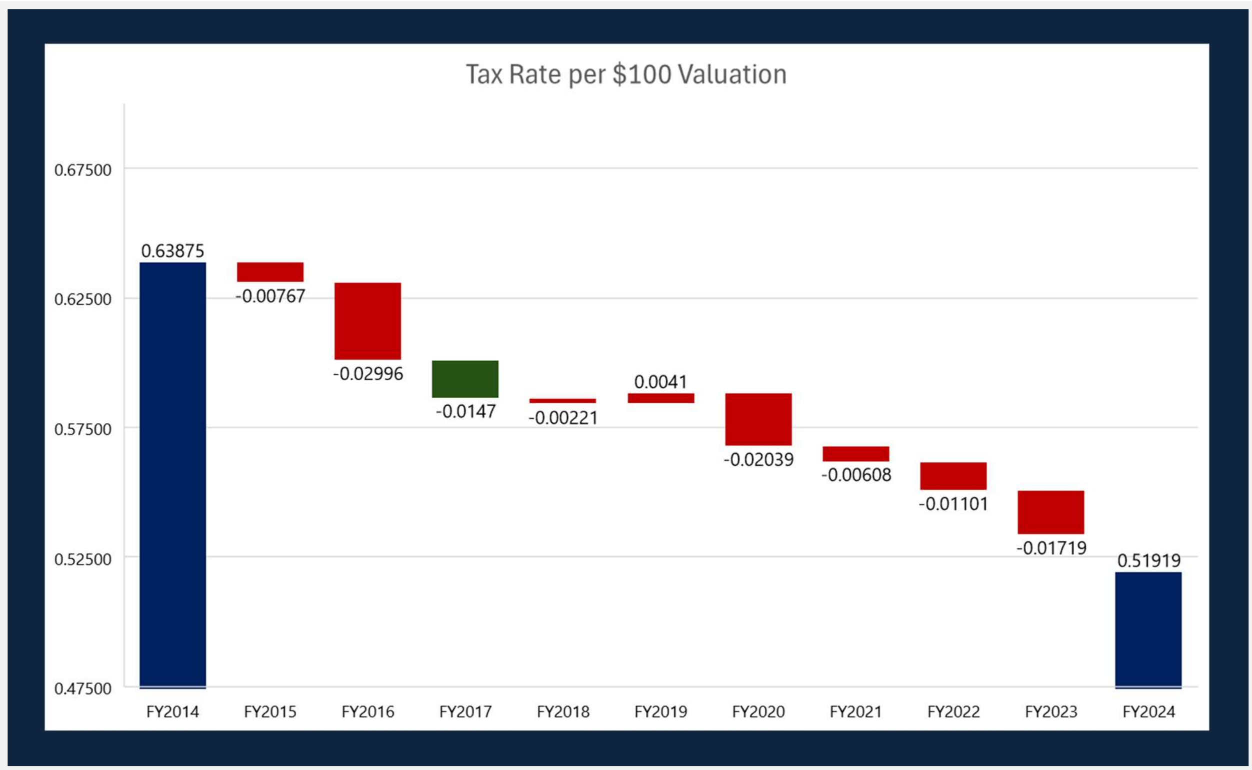
PROPERTY TAX REVENUE

(Amount expressed in millions)



Property Tax revenue is projected to be higher than the Fiscal Year 2025 estimate by 3.2%. The Controllers Office's Property Tax revenue projection is based on a preliminary Prop 1 cap amount of $1.421 billion, which incorporates the 2023 inflation rate of 3.5% and a projected population growth of 0%. The population growth will be updated to reflect the U.S Census Bureau estimates for the period of July 1, 2023, once data becomes available.

PROPERTY TAX RATE



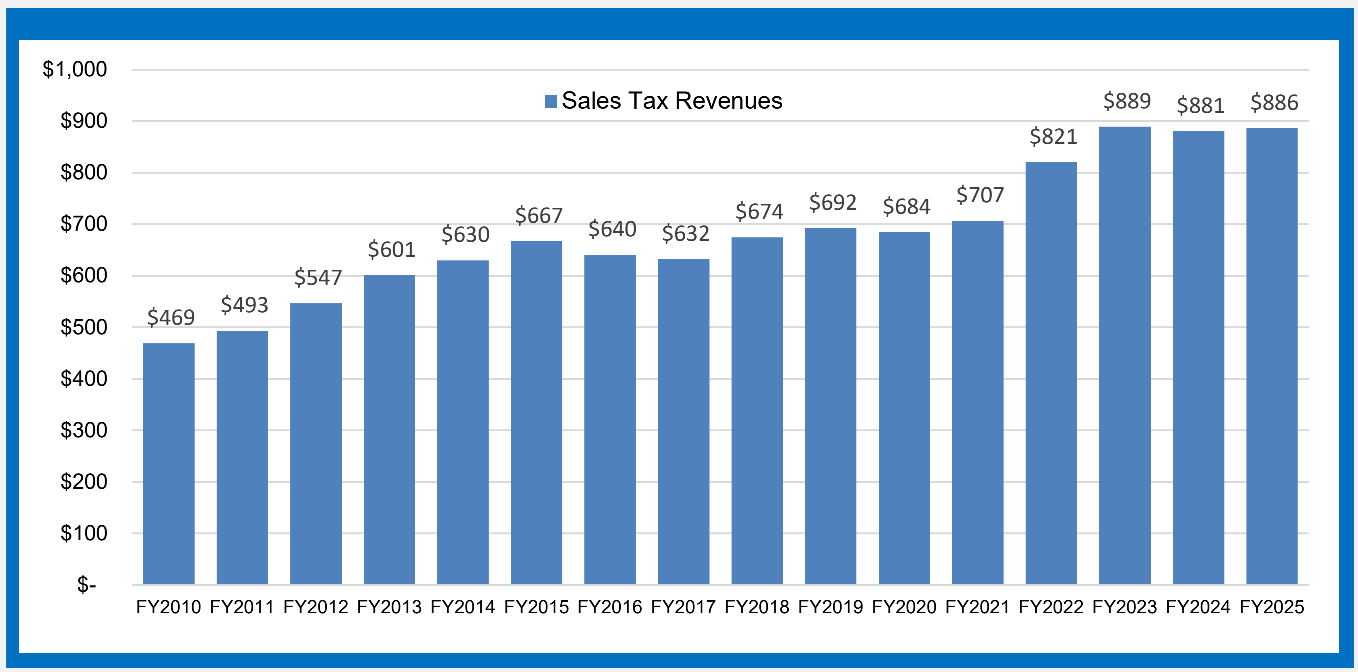
The FY2025 property tax rate projection is based on the FY2024 tax rate of 51.919 cents per $100 taxable value. The final tax rate will be established by a vote of Council in the first quarter of FY2025 when the Certified Roll is available from the three appraisal districts in late August 2024.

The City's property tax rate is also subject to compliance with the State cap (SB2).

As a result of the property tax revenue cap, the tax rate decreased 9 out of the last 10 years since FY2015.

SALES TAX REVENUE

(Amount expressed in millions)

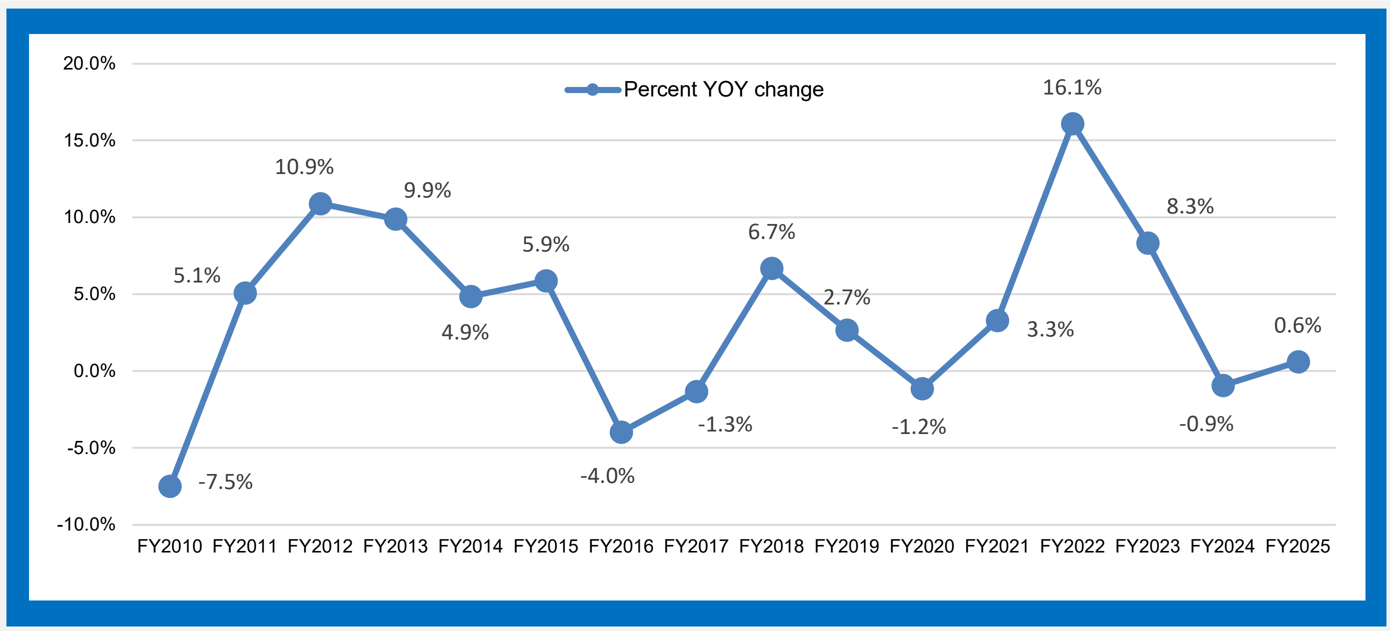


FY2025 Sales Tax revenue is projected to be $886 million, an increase of $5 million, or 0.6% higher than the forecasted FY2024 Sales Tax receipts.

Dr. Gilmer anticipates the Houston economy to normalize and return to pre-COVID trends. This is evident in the consumer sector incomes, employment, and spending. Over the past year, Houston's labor market was strong with no major sectors experiencing employment declines. Employment grew year over year in March by 2.4% (79,340). Consumer spending continues at high rates.

SALES TAX REVENUE

(Amount expressed in millions)

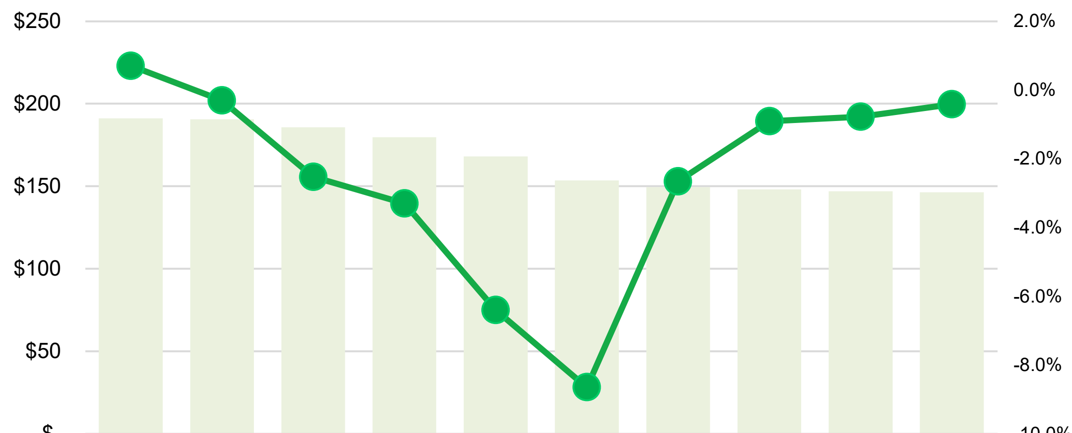


Reflecting on the past, it's evident that sales tax growth can vary considerably from year to year. This variability is attributed to the sensitivity of sales tax to market shifts, as people's spending habits often mirror market trends.

Given its volatility and sensitivity to market trends, we will closely monitor sales tax revenue throughout the year and make necessary adjustments as needed.

FRANCHISE TAX REVENUE

(Amount expressed in millions)



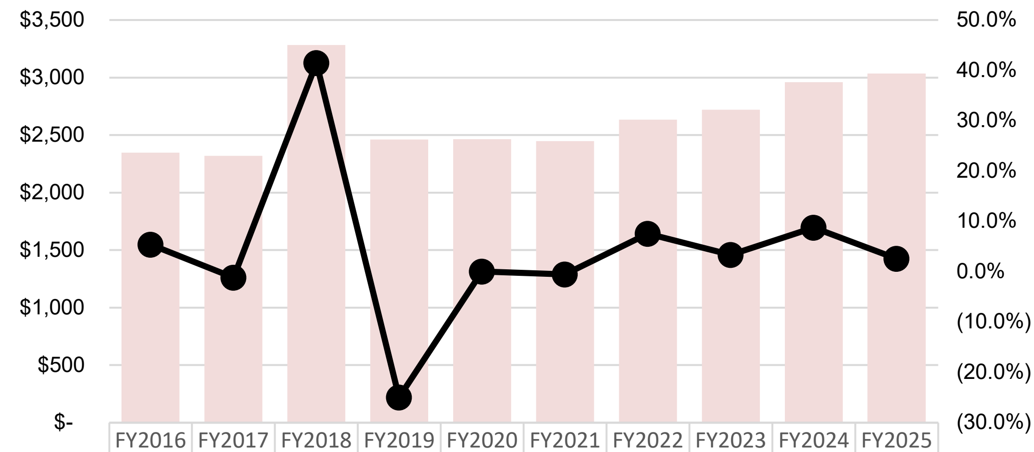
	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Total Franchise Revenue	$191	$191	$186	$180	$168	$154	$150	$148	$147	$146
Percent YOY change	0.7%	-0.3%	-2.5%	-3.3%	-6.4%	-8.6%	-2.7%	-0.9%	-0.8%	-0.4%

Franchise fees are collected from companies, entities, or persons for the privilege of continued use of the city's right ways according to various franchise agreements. Total Franchise Fee revenues are projected to decrease $1.4 million, or 0.9%, for Fiscal Year 2025. Total Franchise Fees are comprised of Electric Franchise, Telephone Franchise, Gas Franchise and Other Franchise.

Electric and Gas Franchise fees are expected to increase by $0.3 million, respectively. Telephone and Other (Cable and Solid Waste Hauler) Franchise fees are expected to decrease by $1.4 million and $0.4 million, respectively.

GENERAL FUND EXPENDITURE BUDGET

(Amount expressed in millions)



	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Total Expenditures	$2,347	$2,319	$3,281	$2,462	$2,462	$2,448	$2,632	$2,721	$2,959	$3,034
Percent YOY change	5.3%	(1.2%)	41.5%	(25.0%)	0.0%	(0.6%)	7.5%	3.4%	8.7%	2.5%

The General Fund Expenditures including debt services transfer and PAYGO are funded by revenues such as property tax, sales tax, franchise fees, and other sources. For Fiscal Year 2025, the General Fund total expenditure budget is expected to increase by $75.4 million, or 2.5% over the Fiscal Year 2024 projected expenditures.

Notable increases include:

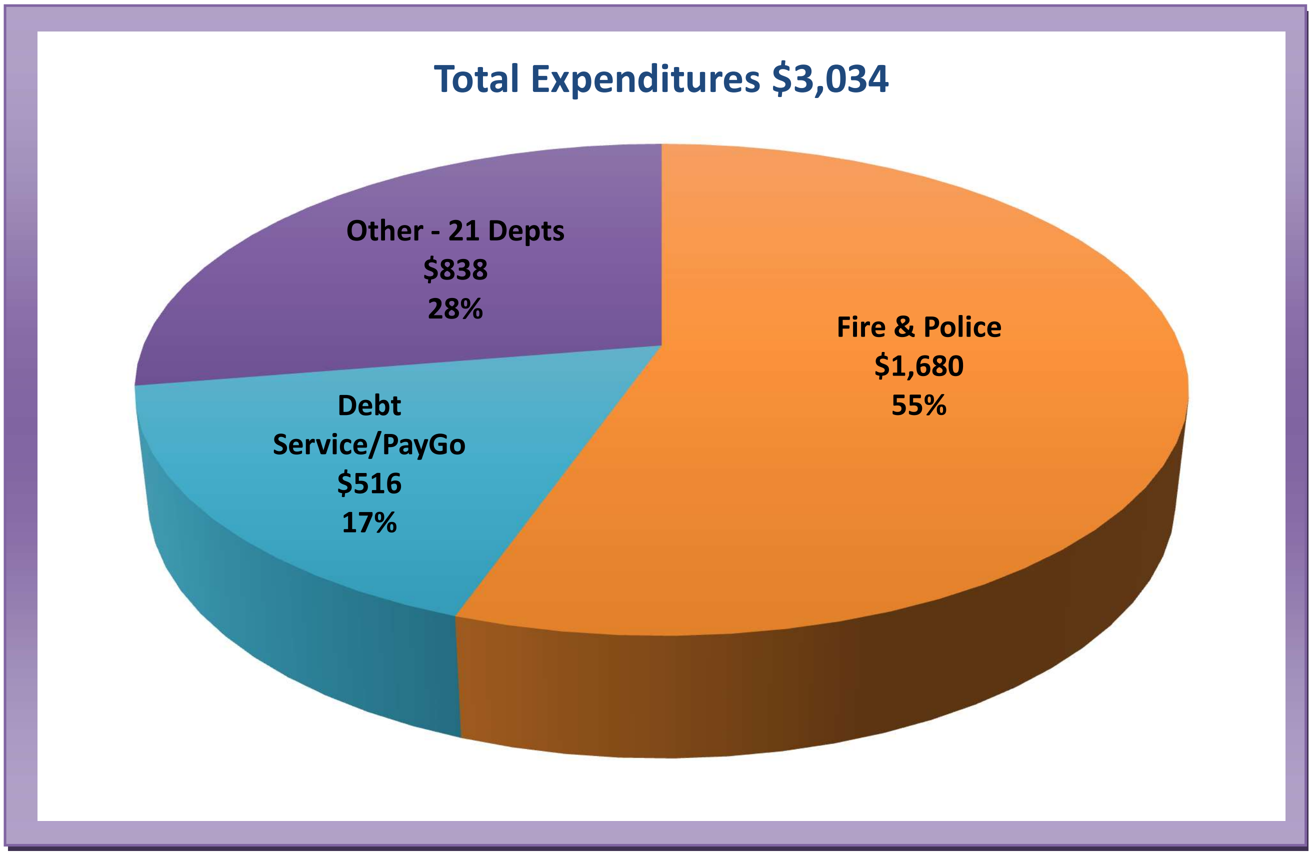
- $40.5 million in debt services primarily related to the firefighter settlement,
- $40.5 million in Fire primarily due to 10% pay increases plus $10 million in special pay under the draft Meet and Confer Agreement,
- $29.2 million in Police primarily due to 3.5% pay increases under the existing Meet and Confer Agreement, offset by
- $23.5 million reduction in General Government primarily due to one-time funding for projects such as Local Drainage Program in FY2024, and
- $11.7 million in departmental reductions.

Although a 2.5% increase may appear modest in comparison to the preceding three years, it represents a significant 24% rise when juxtaposed with FY2021's budget.

GENERAL FUND EXPENDITURE BUDGET

EXPENDITURES BY FUNCTION

(Amount expressed in millions)



The General Fund total expenditures for FY2025 is $3.0 billion of that amount $1.7 billion or 55% of the budget is Fire and Police.

The Other category is compromised of the 21 remaining departments and General Government.

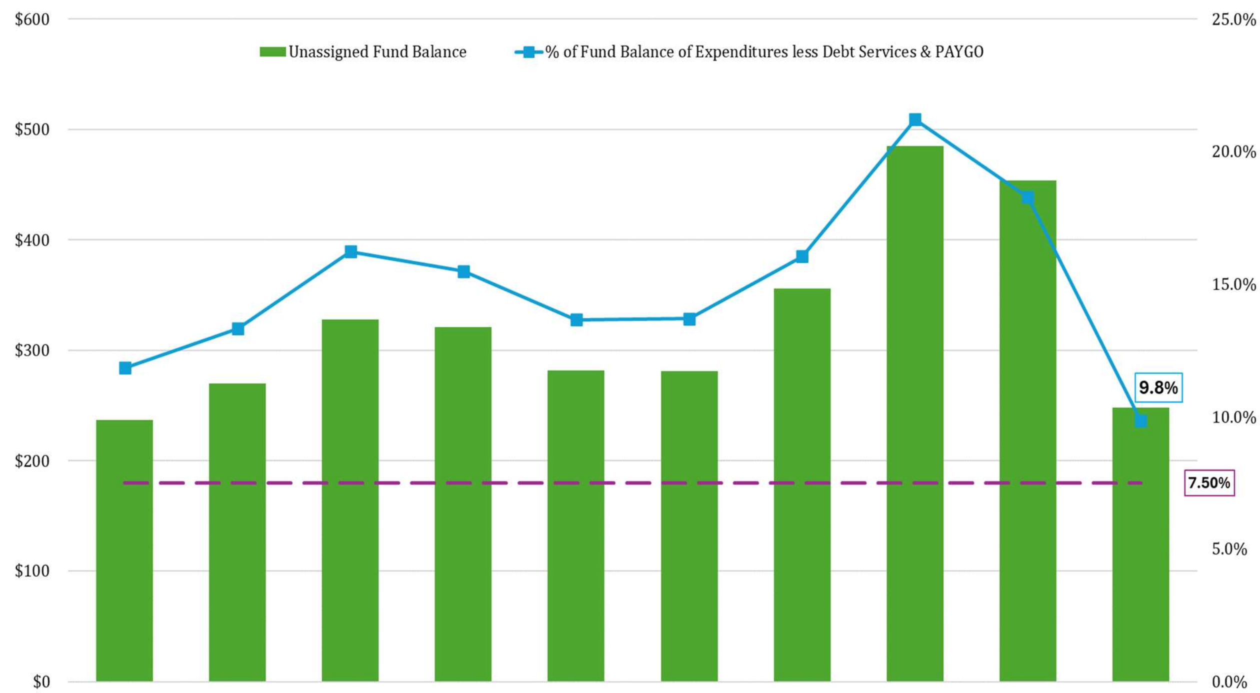
Administration and Regulatory Affairs	General Services	Library
City Controller	Housing	Mayor's Office
City Council	Houston Emergency Center	Municipal Courts Department
City Secretary	Houston Health Department	Office of Business Opportunity
Department of Neighborhoods	Houston Public Works	Parks and Recreation
Finance Department	Human Resources	Planning & Development
*General Government	Legal	Solid Waste Management

* General Government include citywide costs that are not attributable to any single department such as payments to LPAs, Transfers to Component Units, Transfers to Special Rev. Funds, Health Benefit Costs for Retired Civilians, Lease Payments for 611 Walker, etc.

Debt Service/PayGo – Debt Service Payments, General Obligation

FUND BALANCE REQUIREMENT

(Amount expressed in millions)



	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025
Unassigned Fund Balance	$237	$270	$328	$321	$282	$281	$356	$485	$454	$248
Amt. of Required 7.5% Fund Balance	$150	$152	$152	$155	$155	$154	$166	$171	$186	$189
Amt above 7.5% Fund Balance	$87	$118	$176	$166	$127	$127	$190	$314	$268	$59
Fund Balance as a % of Expenditures less Debt Services & PAYGO	11.8%	13.3%	16.2%	15.5%	13.7%	13.7%	16.0%	21.2%	18.3%	9.8%
M&O Expenditures	$ 2,002	$ 2,026	$ 2,021	$ 2,073	$ 2,064	$ 2,051	$ 2,219	$ 2,286	$ 2,484	$ 2,518

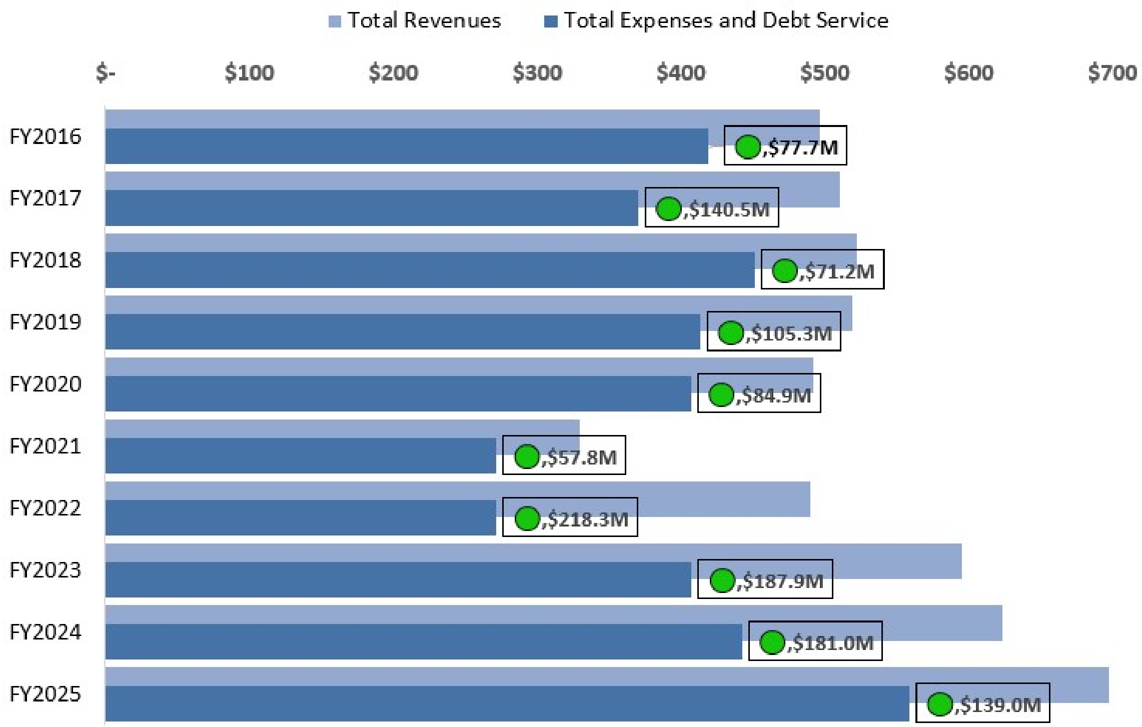
City Ordinance 2014-1078, adopted December 2014, requires an Undesignated Reserve of 7.5% of General Fund Expenditures, less Debt Service Payments and PAYGO.

For Fiscal Year 2025, the Office of the Controller is projecting an ending fund balance of $59 million above the required 7.5%. The projected ending fund balance for Fiscal Year 2025 represents 9.8% of budgeted expenditures excluding debt-service and PAYGO.

HOUSTON AIRPORT SYSTEM

REVENUES AND EXPENSES

(Amount expressed in millions)



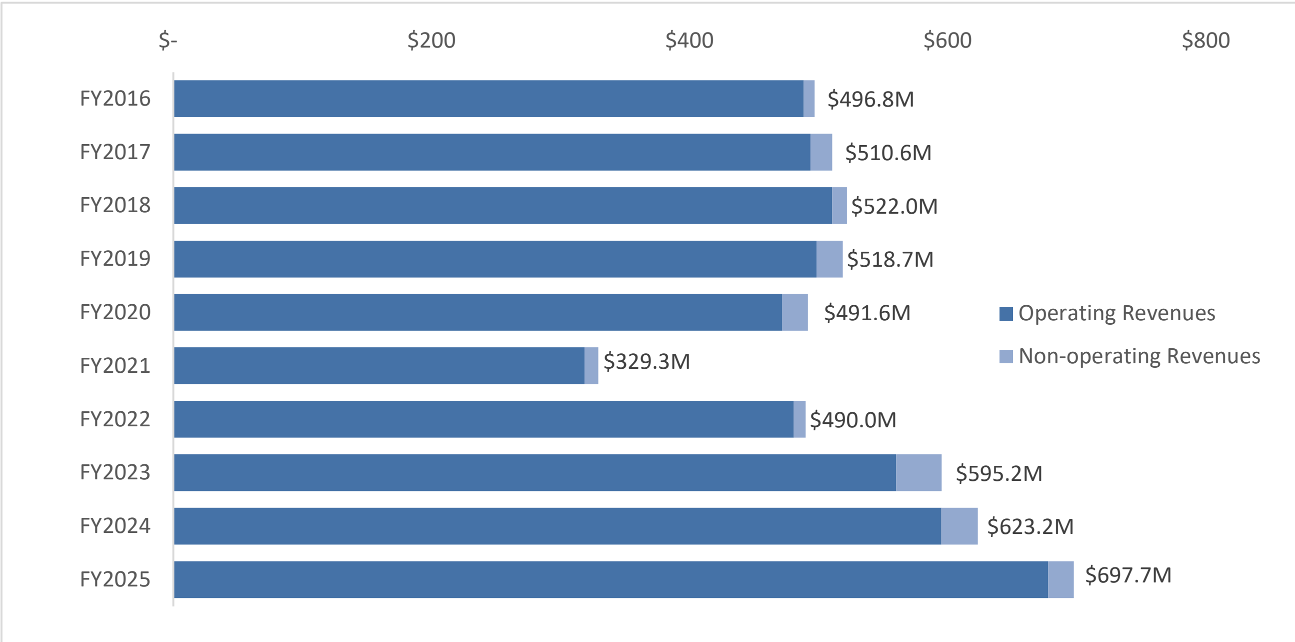
Aviation is projecting revenues to increase by $74.5 million, or 12.0%, to $697.7 million in FY2025. This is primarily attributable to an increase in operating revenues. Total expenses and debt service are expected to increase by $116.5 million, or 26.3%, to $558.7 million in FY2025 primarily due to increased costs in operations & maintenance expenses.

Aviation revenues are projected to exceed expenses by $139.0 million in FY2025, resulting in an increase in ending total net position/fund balance.

HOUSTON AIRPORT SYSTEM

OPERATING AND NON-OPERATING REVENUES

(Amount expressed in millions)

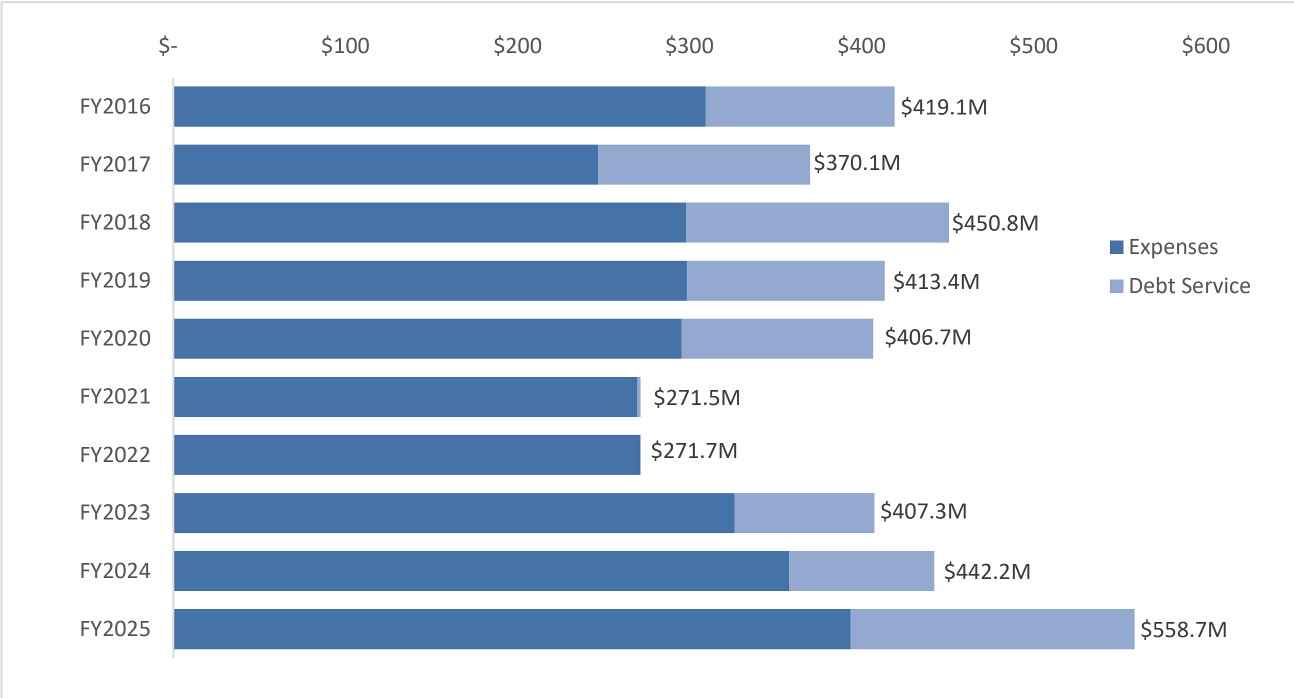


Projected total revenues for Aviation for FY2025 are $697.7 million. This is an increase of $74.5 million, or 12.0%, compared to the FY2024 estimate of $623.2 million. This increase is due to a $82.9 million, or 13.9%, increase in operating revenues primarily due to higher projected Signatory Landing and Terminal Space Rental Fees. Non-operating revenues are estimated to be $19.9 million for FY2025, a decrease of $8.4 million, or 29.6%, compared to FY2024.

HOUSTON AIRPORT SYSTEM

EXPENSES AND DEBT SERVICE

(Amount expressed in millions)



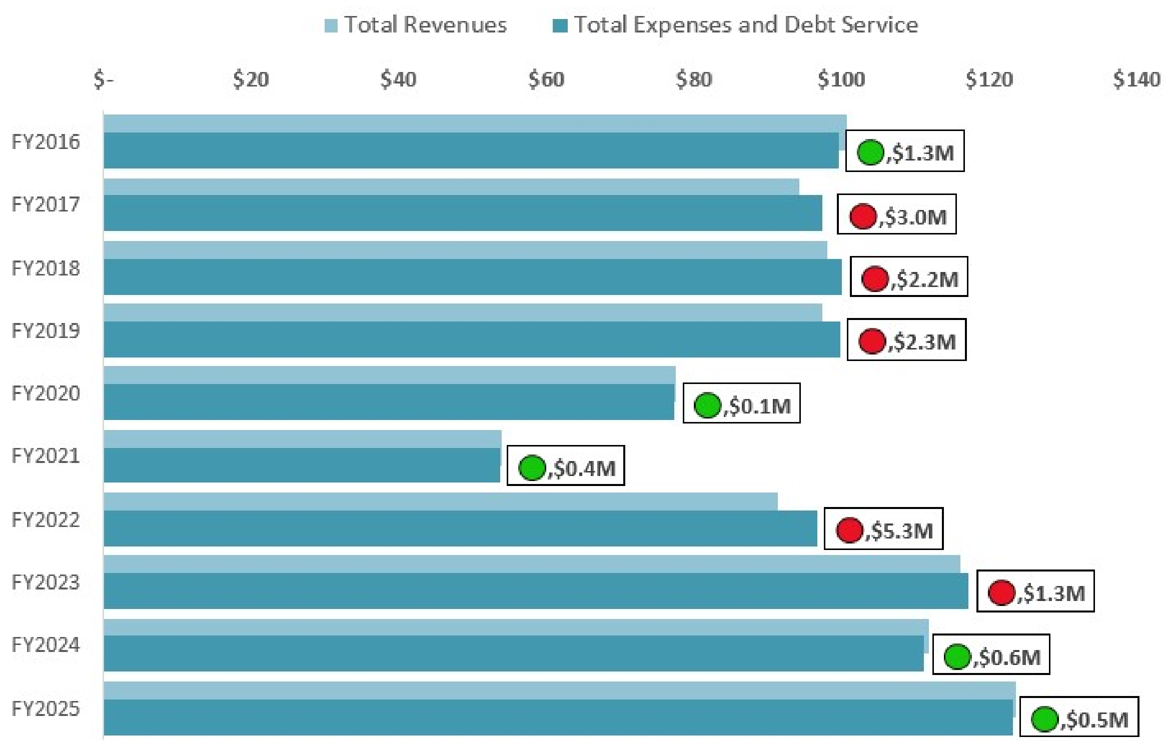
Projected total expenses for Aviation for FY2025 is 558.7 million, an increase of $116.5 million or 26.3% compared to the FY2024 estimate of $442.2 million. This increase is primarily due to debt service transfer of $80.8 million, contracted services and interfund services of $26.1 million and personnel costs of $6.8 million.

FY2024 is the last year of reimbursement from ARPA grant funding for debt service payments.

CONVENTION & ENTERTAINMENT

REVENUES AND EXPENSES

(Amount expressed in millions)

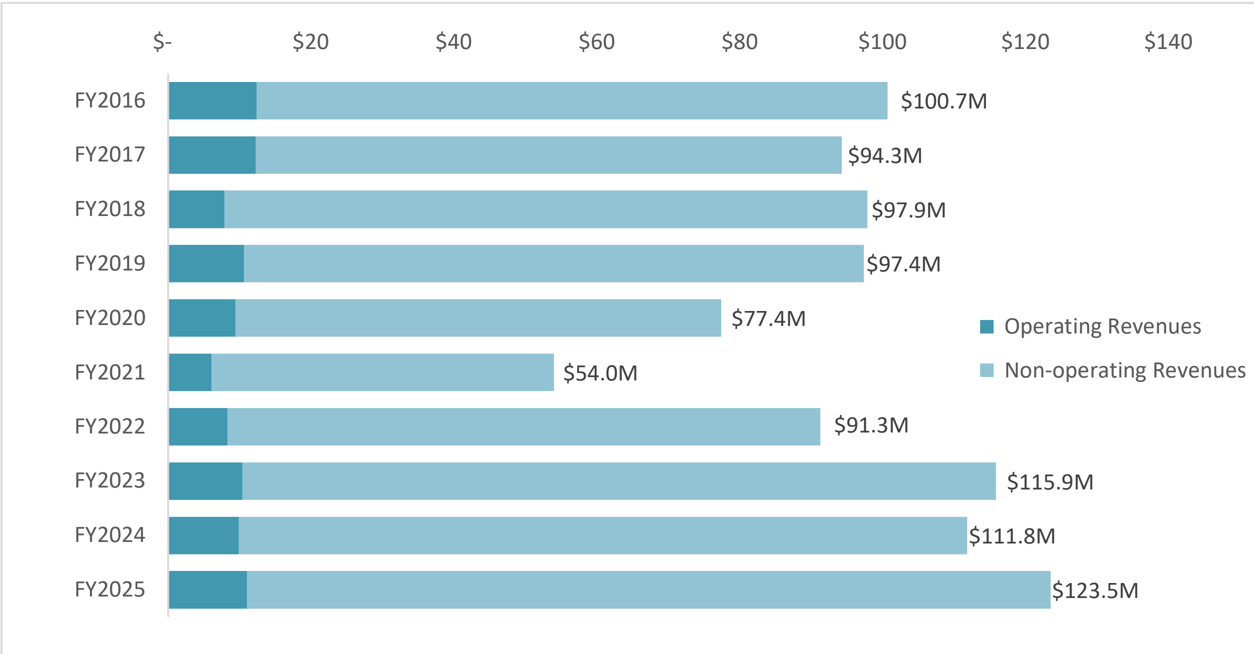


Convention & Entertainment is projecting an increase in total expenses and debt service of $11.8 million, or 10.7%, to $123.0 million in FY2025 compared to FY2024. Revenues are projected to total $123.5 million in FY2025, an increase of $11.7 million, or 10.5%, compared to FY2024. Convention & Entertainment revenues are projected to exceed expenses by approximately $0.5 million in FY2025, resulting in an increase in ending total net position.

CONVENTION & ENTERTAINMENT

OPERATING AND NON-OPERATING REVENUES

(Amount expressed in millions)



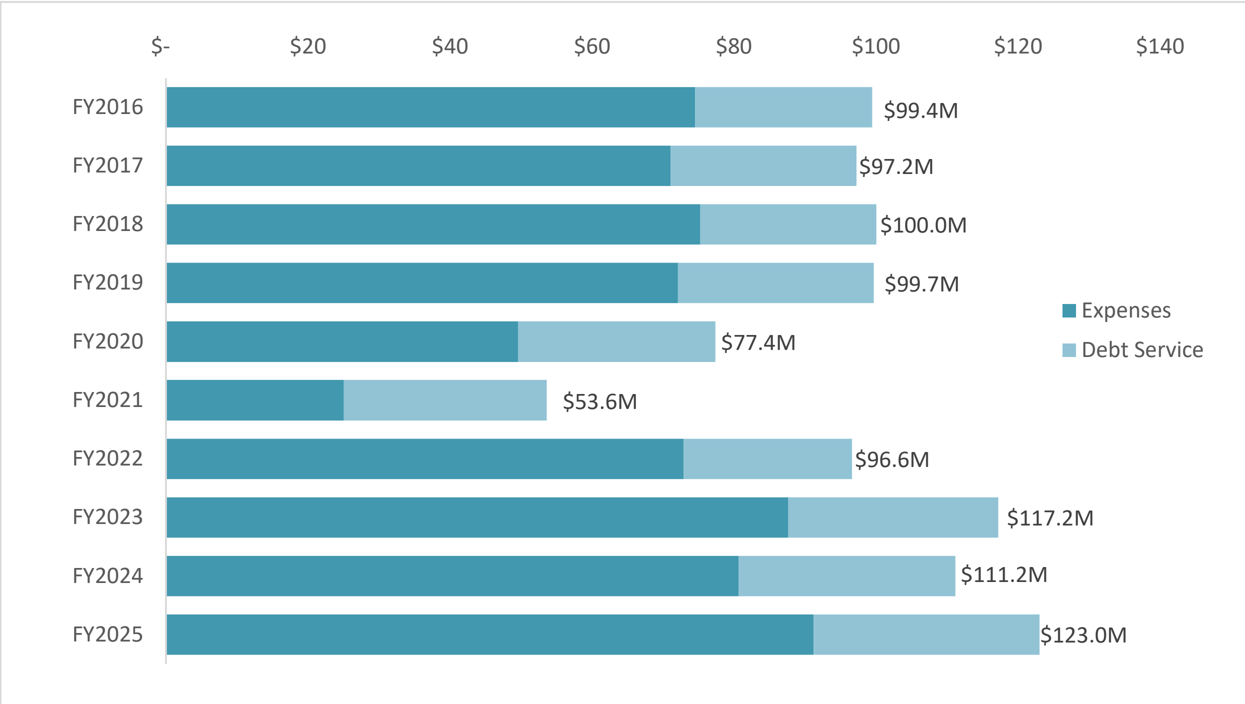
Convention & Entertainment's revenues are primarily generated from Hotel Occupancy Tax (HOT), which is reported as non-operating revenues. Conversely, facility rentals and parking are reported as operating revenues.

Revenues are projected to total approximately $123.5 million in FY2025. Collection of HOT is projected to increase by $10.2 million, or 10.1%, to $111.4 million in FY2025 from FY2024 due to higher occupancy rates and higher average daily rates expected in FY2025. In addition, total operating revenues are projected to increase by $1.2 million, or 11.7%, to $11.1 million in FY2025, primarily the result of higher parking revenues from higher utilization and parking garages rates.

CONVENTION & ENTERTAINMENT

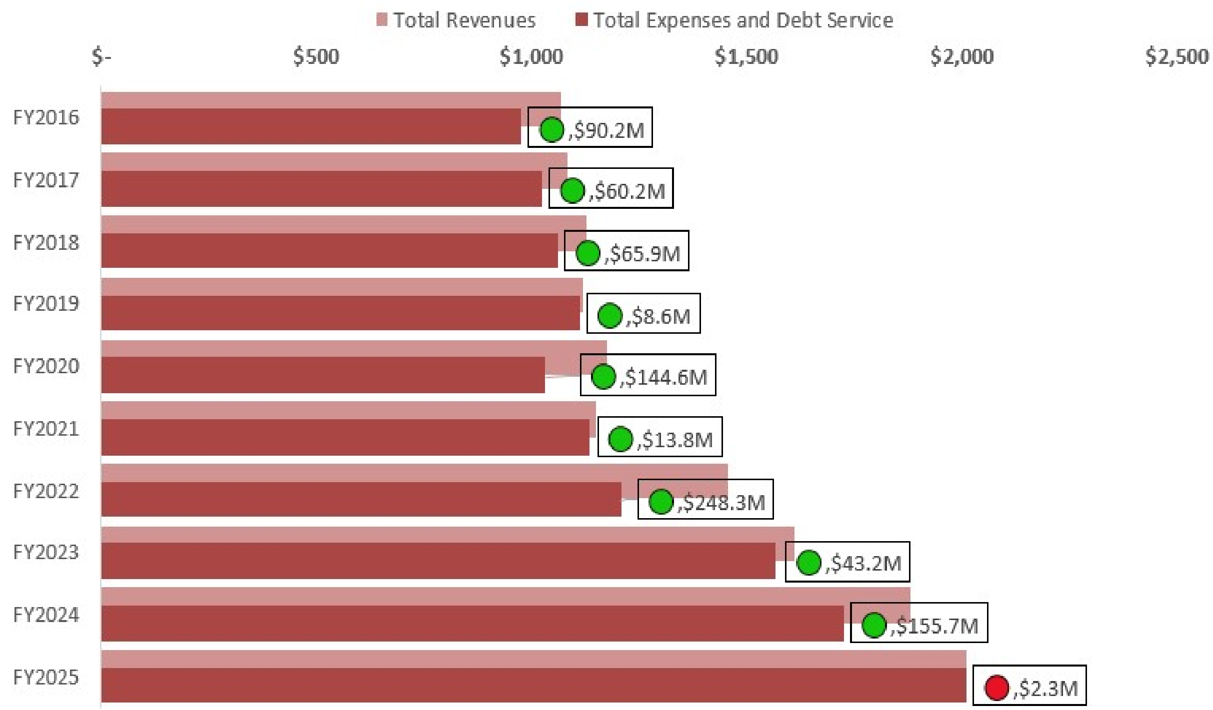
EXPENSES AND DEBT SERVICE

(Amount expressed in millions)



Convention & Entertainment is projecting an increase of $11.8 million, or 10.7%, in total expenses to $123.0 million in FY2025 compared to FY2024. This increase is primarily due to higher transfers to Houston First Corporation in the amount of $89.2 million, this is $10.6 million higher than FY2024.

COMBINED UTILITY SYSTEM
REVENUES AND EXPENSES
(Amount expressed in millions)



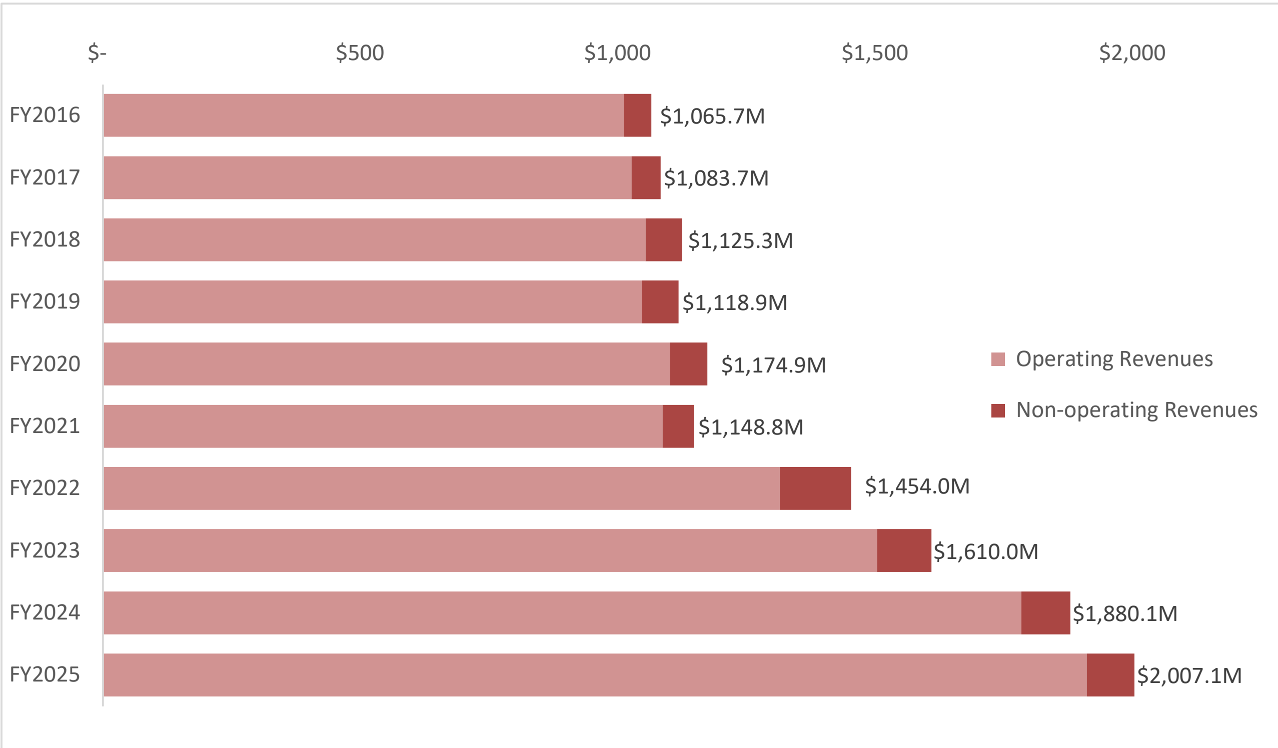
The Combined Utility System's (CUS) revenues are expected to increase by $127.0 million, or 6.8%, to $2,007.1 million in FY2025. Expenses are expected to increase by $285.0 million or 16.5% to $2,009.4 million in FY2025, mainly due to increases in transfers to debt service and capital projects, as well as operating expenses such as personnel, supplies and contract services. The Combined Utility System's expenses are projected to exceed revenues by approximately $2.3 million for FY2025, resulting in a decrease in ending total net position/fund balance.

City ordinance requires remaining funds, after all expenses and other financial obligations are met (CUS' net revenues), are transferred to the CUS General Purpose Fund. The funds within the CUS General Purpose Fund are available to pay for any lawful purpose and for drainage purposes, subject to certain restrictions.

COMBINED UTILITY SYSTEM

OPERATING AND NON-OPERATING REVENUES

(Amount expressed in millions)



CUS revenues are expected to increase by $127.0 million, or 6.8%, compared to FY2024. This increase is primarily due to projected increases of $47.6 million in water sales for a total of $965.2 million and $84.9 million in sewer sales totaling to $912.0 million. The increase in water and sewer sales is offset by a decrease of $5.7 million primarily due to lower water and sewer penalties and other revenue fees.

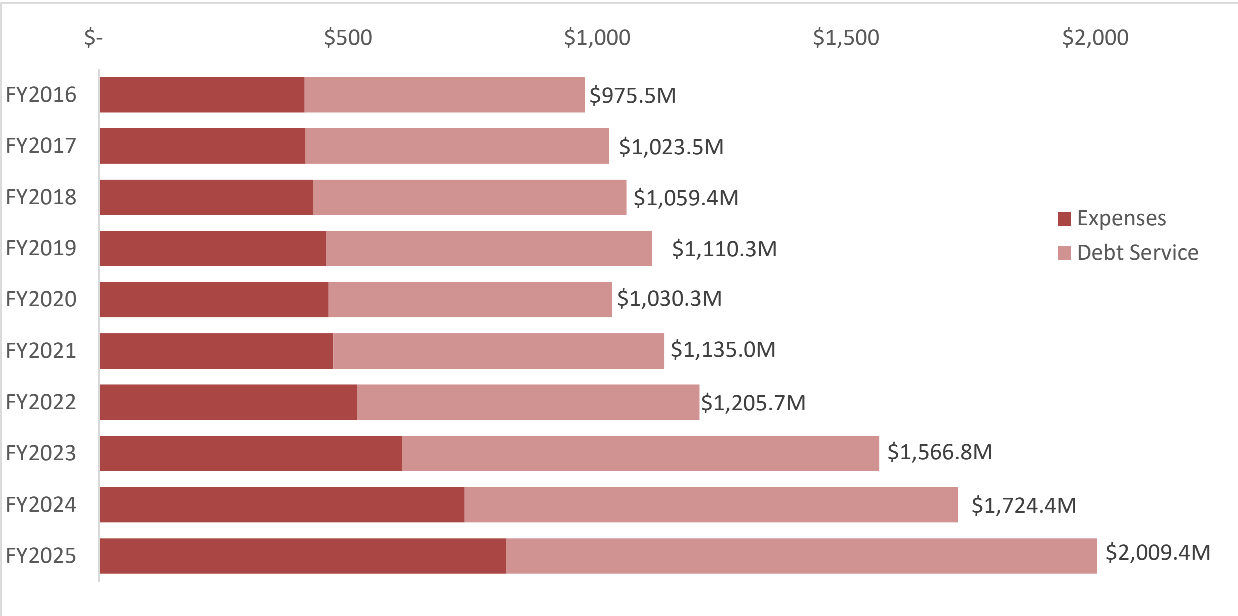
Water and sewer sales are subject to an annual inflationary rate adjustment equal to the previous calendar year's Producer Price Index (PPI) or Consumer Price Index (CPI) and population for the Houston area. The rate adjustments for fiscal years 2016 to 2025 are as follows:

Fiscal Years	Rate Adjustments	Fiscal Years	Rate Adjustments
2016	4.4%	2021	3.5%
2017	1.4%	2022	1.5%
2018	3.4%	2023	5.6%
2019	2.8%	2024	9.2%
2020	2.8%	2025	9.0%

COMBINED UTILITY SYSTEM

EXPENSES AND TRANSFERS

(Amount expressed in millions)



CUS expenses are expected to increase by $285.0 million, or 16.5%, to $2,009.4 million in FY2025 compared to FY2024 primarily due to increases in operating & maintenance costs operating transfers and debt service transfers. Operating & maintenance costs increased by $82.9 million to $817.3 million, operating transfers increased by $202.1 million to $1,192.1 million.

Changes in operating and maintenance expenses reflect increases to personnel expenses, energy expense components, supplies and additional resources to accommodate new customers or additional regulatory compliance. The number of full-time equivalent employees (FTEs) is projected to increase by 15.9 FTEs to 2,412.8 FTEs in FY2025.

Operating transfers include CUS debt service payment obligations, transfers to capital projects and other funds, as well as drainage expenses.