



Finance Department

Presentation to the City of Houston Budget and Fiscal Affairs Committee

Bridging the Budget Gap FY2015-FY2019: A First Look

July 29, 2014

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FY2015-19 General Fund Forecast

(\$ in thousands)

	<u>FY2015</u> Adopted	<u>FY2016</u> Forecast	<u>FY2017</u> Forecast	<u>FY2018</u> Forecast	<u>FY2019</u> Forecast
Property Tax (1)	1,067,338	1,105,943	1,146,062	1,187,747	1,231,065
Sales Tax	666,968	701,650	738,838	777,996	819,230
Franchise Revenue	185,099	182,605	180,368	178,362	176,565
Other Revenues	258,867	264,816	271,100	277,745	284,780
Transfers from Other Funds - Ongoing	30,139	30,139	30,139	30,139	30,139
Sale of Land - Ongoing	2,500	2,500	2,500	2,500	2,500
One Time Revenue	0	0	0	0	0
Total Revenues and Other Sources	2,210,910	2,287,653	2,369,006	2,454,488	2,544,279
<i>Growth %</i>	6%	3%	4%	4%	4%
Total Operating Expenditures Net of Pension	1,722,757	1,760,848	1,829,552	1,954,574	2,020,479
Pension (2)	263,613	331,966	351,853	326,989	351,297
Transfers for Debt Service	273,000	338,892	350,897	380,423	356,551
Total Expenditures Including Debt	2,259,370	2,431,705	2,532,302	2,661,987	2,728,327
<i>Growth %</i>	8%	8%	4%	5%	2%
Net Revenues Less Expenditures	(48,460)	(144,052)	(163,297)	(207,498)	(184,048)
Use of Fund Balance	48,460	0	0	0	0
Other Sources and Uses	48,460	0	0	0	0
Net Surplus/(Deficit)	(0)	(144,052)	(163,297)	(207,498)	(184,048)
Beginning Fund Balance	204,549	156,089	156,089	156,089	156,089
Ending Unrestricted Fund Balance (3)	156,089	156,089	156,089	156,089	156,089
Fund Balance Percent of Expenditures (less debt)	7.9%	7.5%	7.5%	7.5%	7.5%

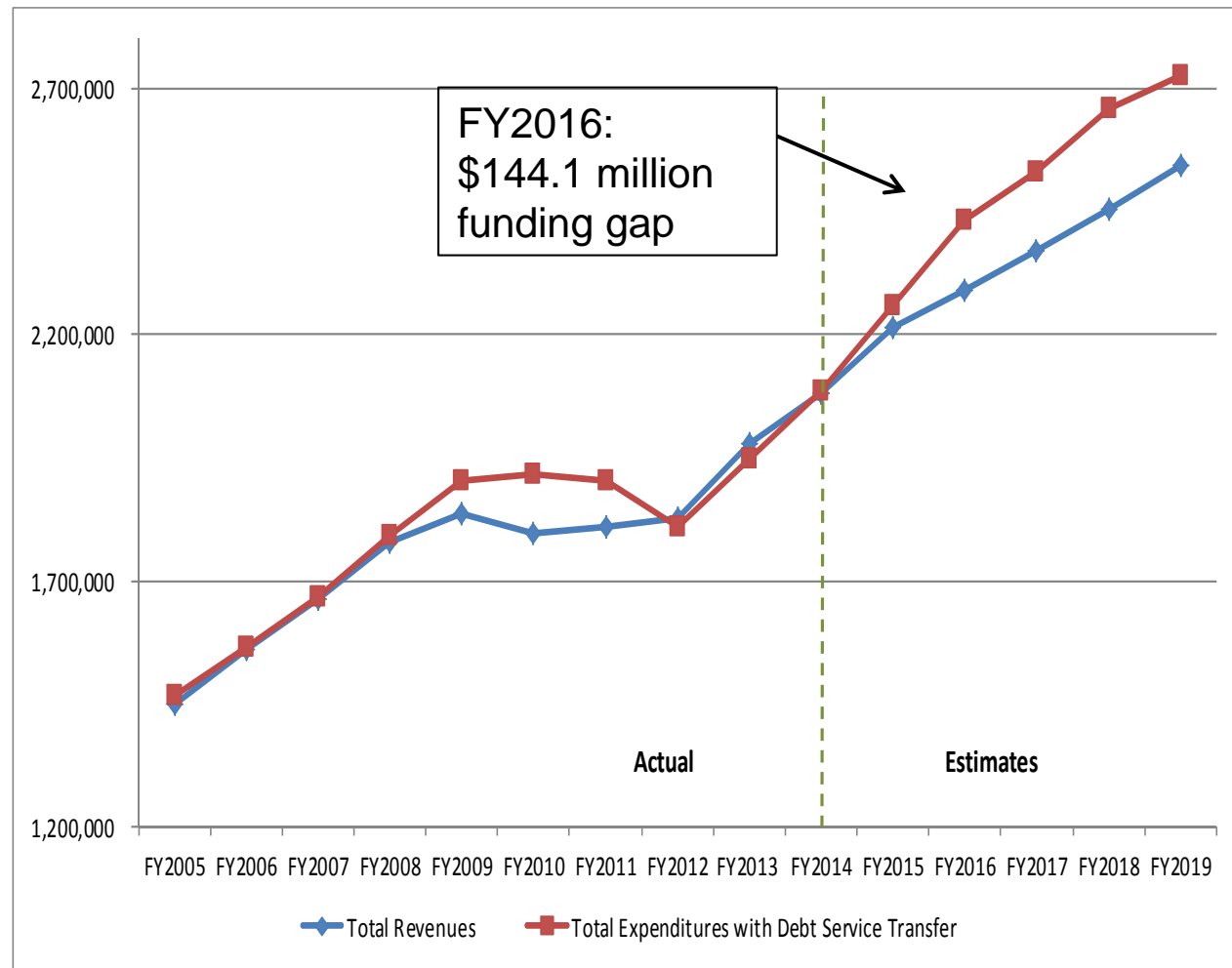
Notes:

- (1) Property Tax Estimate for FY2016 – 2019 is based on the maximum allowed by charter cap.
- (2) Pension costs include projected \$50 million "catch -up" payments to HPOPS for police pensions in FY2016 and FY2017.
- (3) Ending Unrestricted Fund Balance figure is set at 7.5 percent of total expenditures less debt.



FY2015-19 General Fund Forecast

Continued



Note: Dollars in thousands; total revenue does not include one-time revenue sources



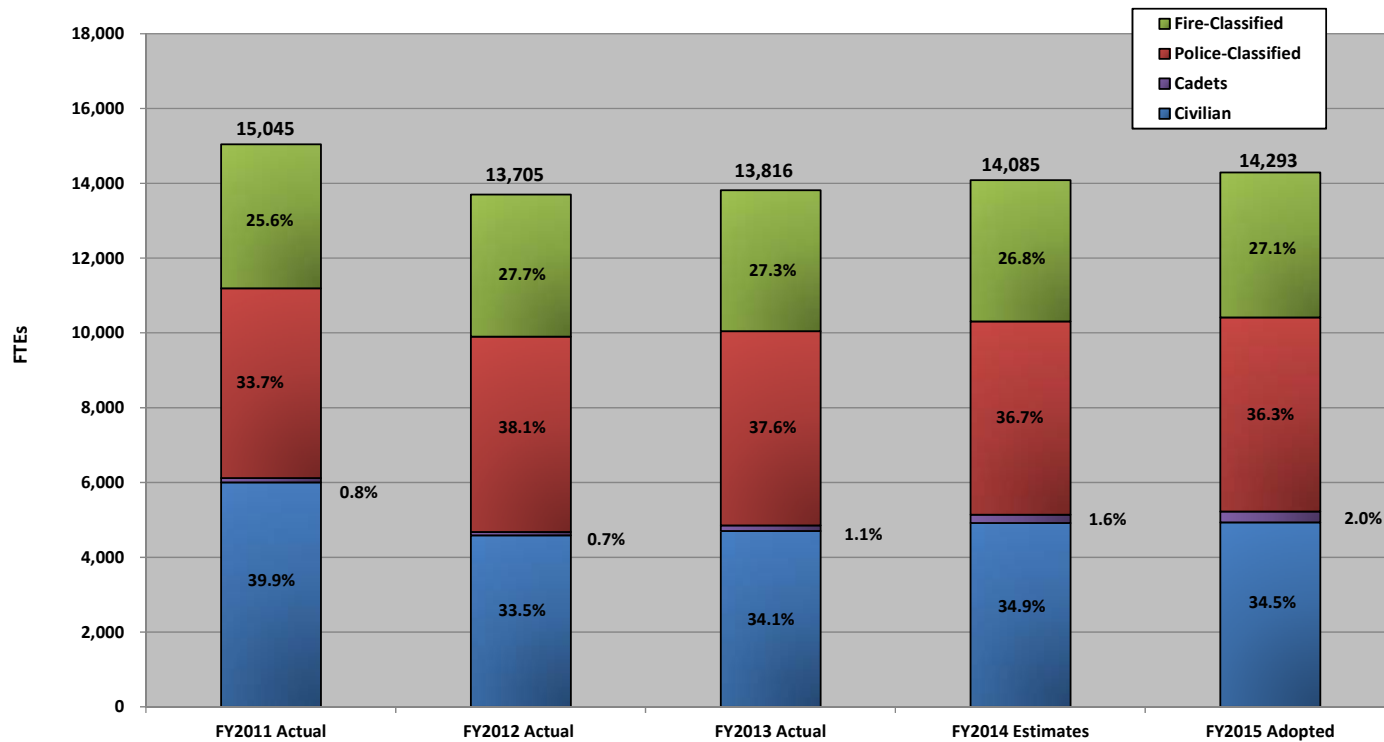
Looking Ahead: The FY2016 Budget Gap

<u>Anticipated Expenditure Increases Over Base*</u>	<u>\$MIL</u>
Pension Contributions	(\$68.4)
Debt Service (inclusive of DDSRF)	(\$33.4)
Contractual Police Pay Increase Scheduled on 6/30/15	(\$17.9)
Salary and Health Benefits Contingency	(\$34.2)
Maintenance Renewal & Replacement	(\$4.8)
Other Cost Increases	<u>(\$13.7)</u>
Total Anticipated Expenditure Increases	(\$172.4)
FY2016 Revenue Over Base*	<u>\$28.3</u>
Total FY2016 Gap with Charter Cap	(\$144.1)
Total FY2016 Gap without Charter Cap (see appendix)	(\$127.2)

* Note: FY15 Adopted Budget used as base.



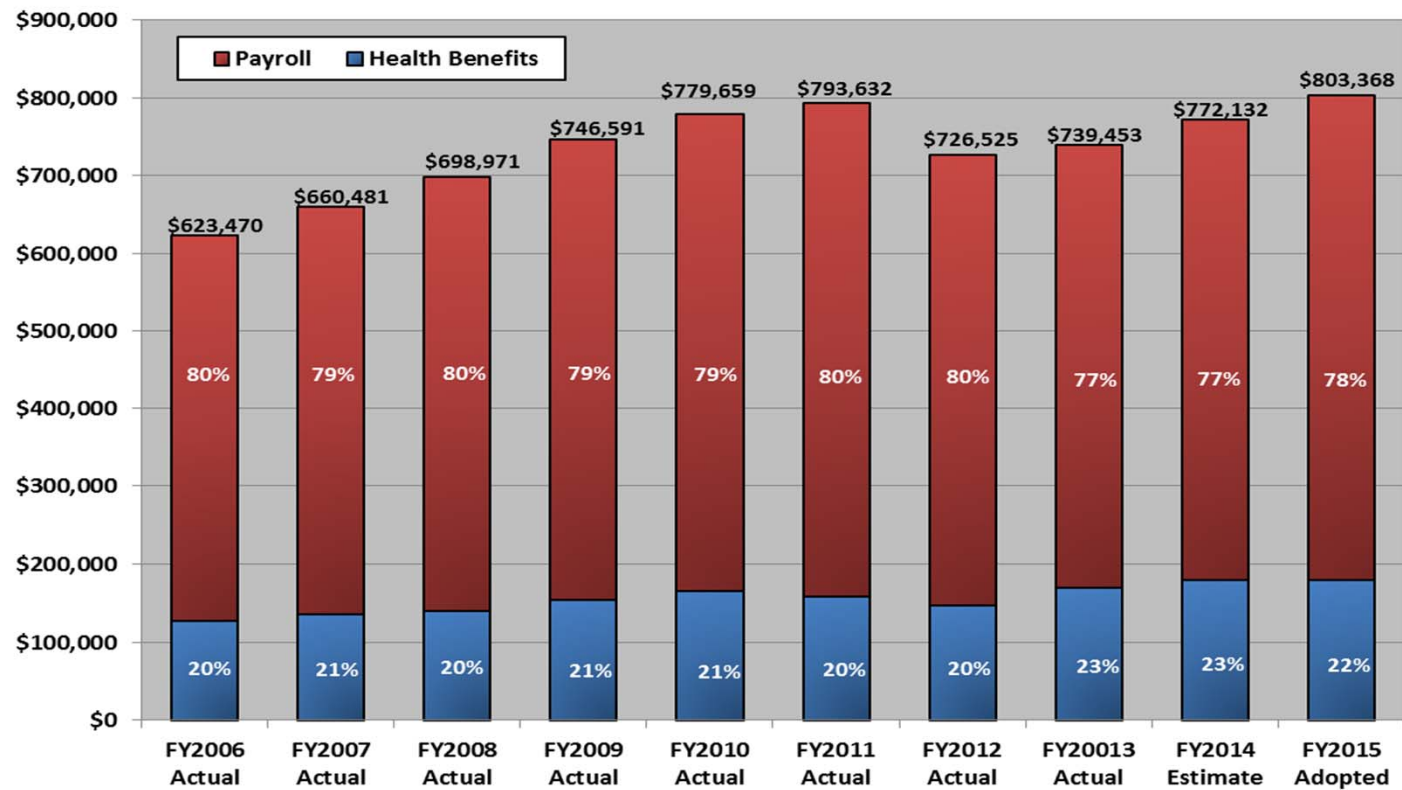
The Number of General Fund Full-Time Equivalent (FTE) Employees Is Not Driving Cost Increases



	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Estimates	FY2015 Adopted
Civilian	6,004	4,589	4,705	4,918	4,932
Police-Classified	5,073	5,224	5,196	5,168	5,194
Police-Cadets	70	77	121	89	113
Fire-Classified	3,854	3,801	3,768	3,775	3,876
Fire-Cadets	45	14	27	135	178
Total	15,045	13,705	13,816	14,085	14,293
Change YOY (FTEs)		(1,341)	112	269	208
Change YOY (%)		-8.91%	0.81%	1.95%	1.48%



General Fund Health Benefits as % of Payroll (\$ in Thousands)



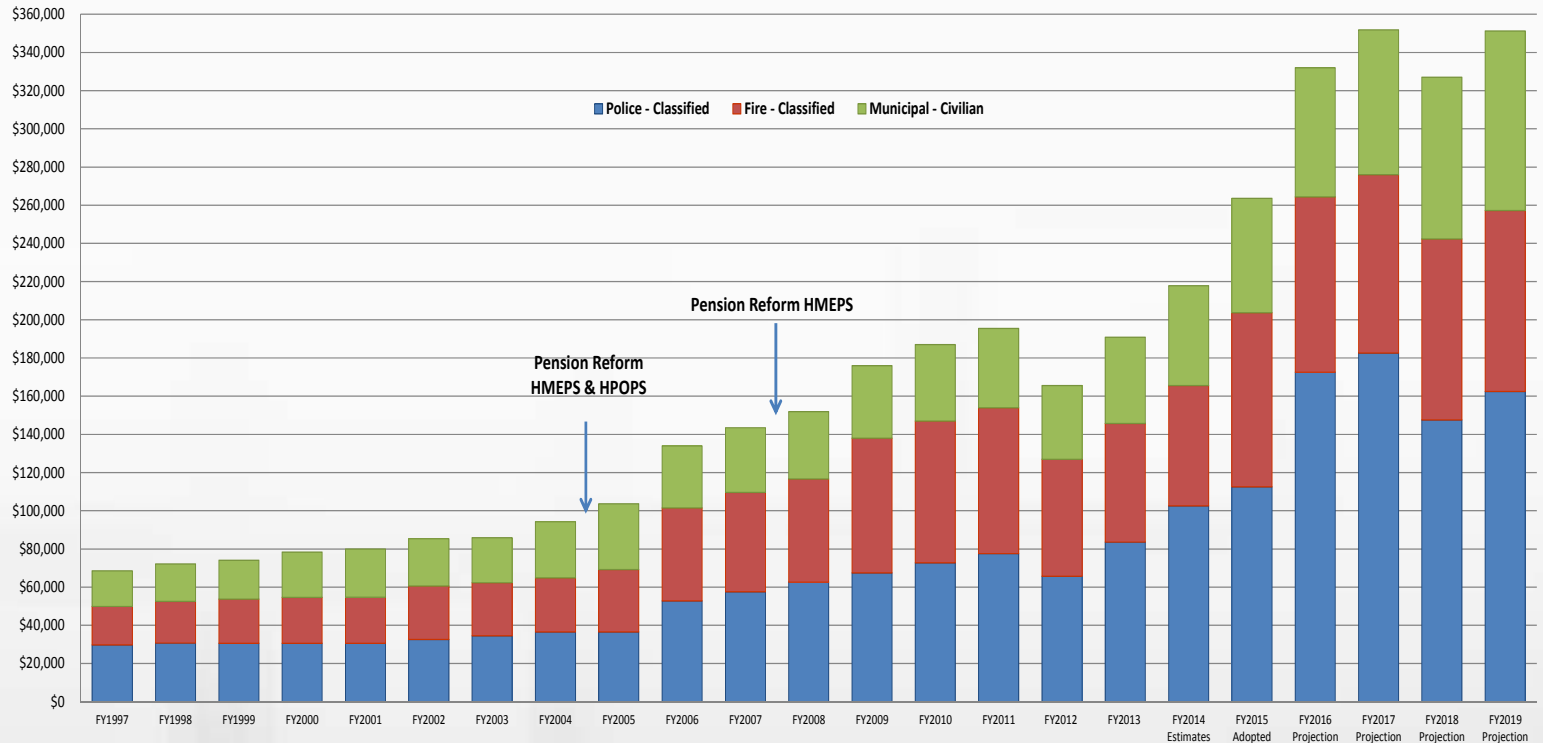
	FY2006 Actual	FY2007 Actual	FY2008 Actual	FY2009 Actual	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Estimate	FY2015 Adopted
Payroll	\$ 623,470	\$ 660,481	\$ 698,971	\$ 746,591	\$ 779,659	\$ 793,632	\$ 726,525	\$ 739,453	\$ 772,132	\$ 803,368
Change YOY		5.94%	5.83%	6.81%	4.43%	1.79%	-8.46%	1.78%	4.42%	4.05%
Health Benefits	\$ 127,717	\$ 136,542	\$ 140,566	\$ 155,018	\$ 165,190	\$ 159,119	\$ 147,077	\$ 169,868	\$ 179,318	\$ 179,357
Change YOY		6.91%	2.95%	10.28%	6.56%	-3.68%	-7.57%	15.50%	5.56%	0.02%
Health Benefits as % of Payroll	20%	21%	20%	21%	21%	20%	20%	23%	23%	22%

Notes:

- Health Expense includes only City contributions for HMO, PPO, and Medicare Advantage Health Care Plans and Payroll includes only Base Salary Pay.
- This chart also includes payroll and health benefits funding for Forensic Transition Special Fund in FY2015.



Increasing General Fund Pension Expenditures are Crowding Out Headcount/Services (\$ in Thousands)



Pension	FY1997	FY1998	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Police - Classified	\$29,731	\$30,645	\$30,538	\$30,551	\$30,615	\$32,551	\$34,532	\$36,523	\$36,502	\$52,697	\$57,597	\$62,627	\$67,495	\$72,669	\$77,534	\$65,701	\$83,526	\$102,550	\$112,506	\$172,506	\$182,506	\$147,506	\$162,506
Fire - Classified	\$20,175	\$21,884	\$23,220	\$24,093	\$24,076	\$27,979	\$27,772	\$28,325	\$32,699	\$48,738	\$51,984	\$53,981	\$70,506	\$74,299	\$76,352	\$61,204	\$62,141	\$62,958	\$91,232	\$91,875	\$93,512	\$94,822	\$94,696
Municipal - Civilian	\$18,660	\$19,610	\$20,317	\$23,675	\$25,253	\$24,812	\$23,524	\$29,317	\$34,437	\$32,501	\$33,932	\$35,278	\$37,994	\$40,017	\$41,537	\$38,662	\$45,219	\$52,365	\$59,875	\$67,584	\$75,836	\$84,661	\$94,095
Total	\$68,566	\$72,139	\$74,075	\$78,319	\$79,944	\$85,342	\$85,828	\$94,165	\$103,638	\$133,936	\$143,513	\$151,886	\$175,995	\$186,985	\$195,423	\$165,567	\$190,886	\$217,873	\$263,613	\$331,966	\$351,853	\$326,989	\$351,297
% Growth	2.29%	5.21%	2.68%	5.73%	2.07%	6.75%	0.57%	9.71%	10.06%	29.23%	7.15%	5.83%	15.87%	6.24%	4.51%	-15.28%	15.29%	14.14%	20.99%	25.93%	5.99%	-7.07%	7.43%

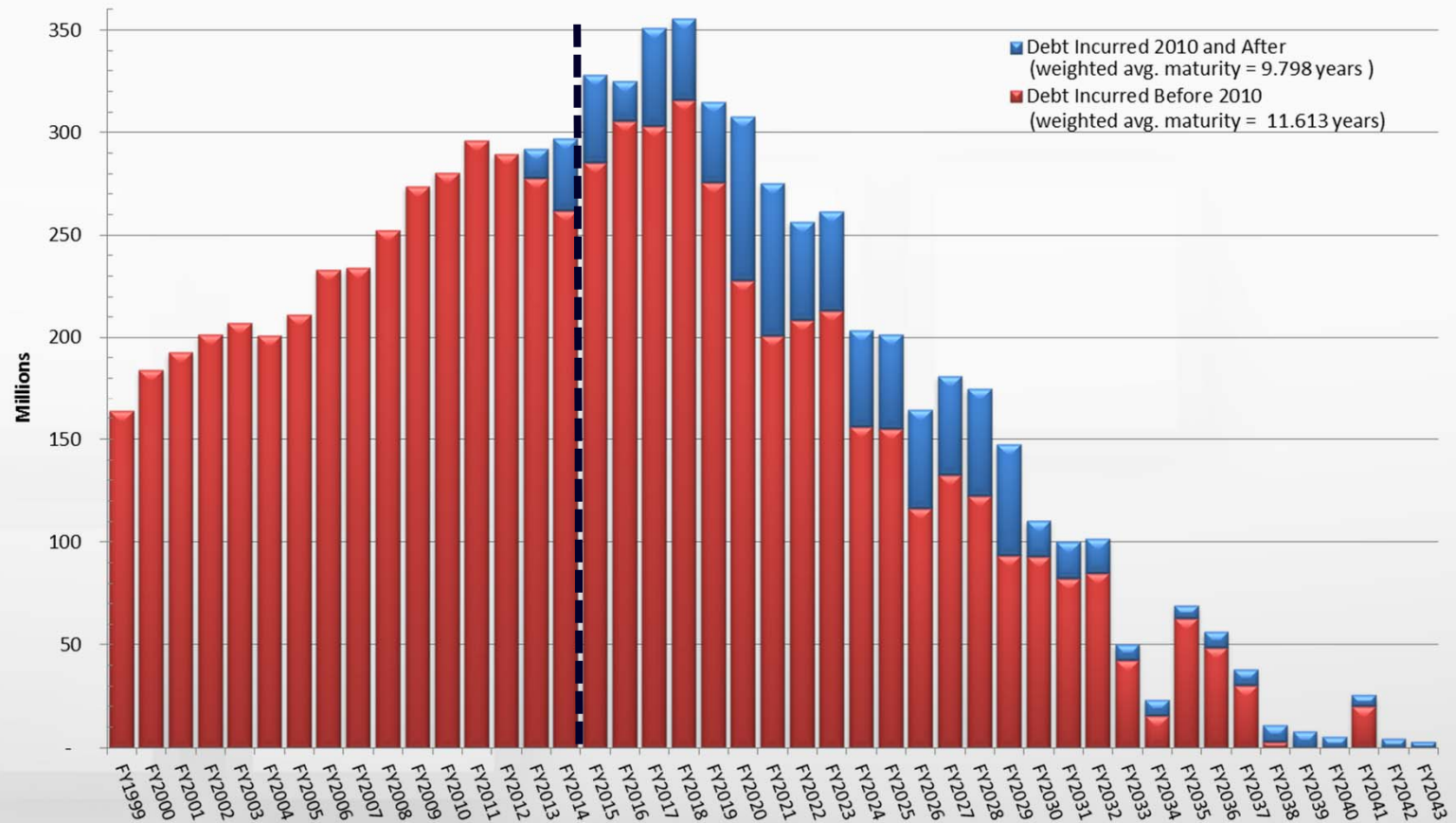
- FY2016 and 2017 include projected \$50 million “catch-up” payments to HPOPS for police pension



(\$ in Thousands)

General Obligation Debt Service - Existing Debt

Payments from Debt Service Fund Rise Before Decreasing In FY2019



Note: Chart reflects actual debt payments, not total General Fund transfer to Debt Service Fund referenced on slide 8. Available refinancing options have been exhausted.

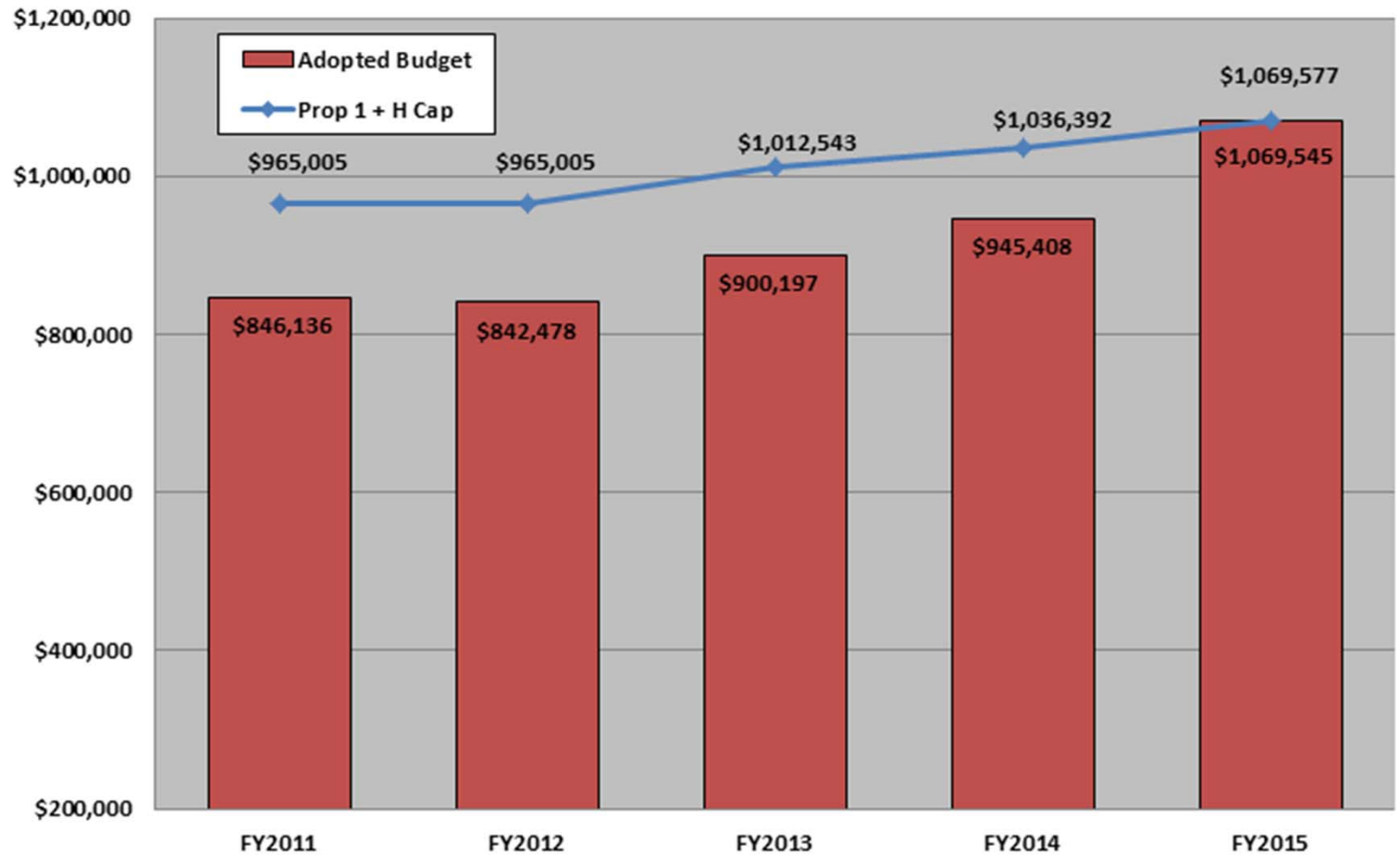


Property Tax Cap: Reality in FY2016

- **Proposition 1** (Tax Cap): Voters approved in 2004 – charter amendment limits the growth of City’s property tax revenue to the lesser of population and inflation growth or 4.5% growth
- **Proposition H**: 2006 -- Voters allow City officials to raise an additional \$90 million above the limit for public safety



Property Tax Revenue Reaches Cap in FY2015 FY2011 - FY2015 (\$ in Thousands)

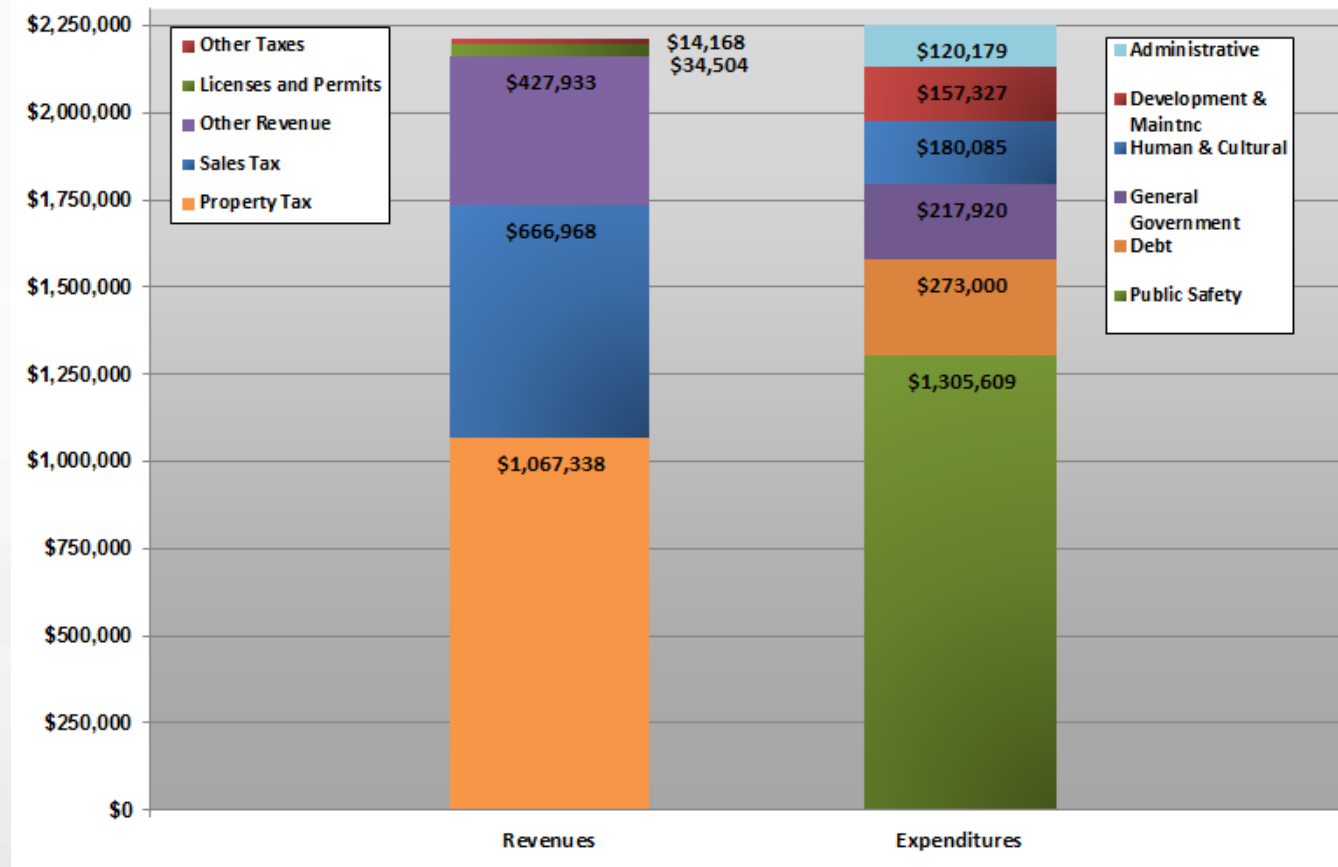


Rapid economic recovery spurs significant revenue growth in FY2015, eliminating “cushion” between property tax revenue and cap



FY2015 Revenue versus Expenditures

(\$ thousands)



Property tax alone does not cover cost of essential services; sales tax is a highly volatile source of revenue.



Closing the Gap: No Silver Bullet

There is no one solution to bridging the funding gap. The answer will be a combination of some or all of the following approaches:

- Cut programs or services
- Cut health benefits costs
- Pursue non-tax revenue options
- Secure voter approval to lift or modify cap on property tax revenue
- Control rising pension costs

We have a number of efficiency efforts underway which will continue.



Cut Programs or Services

Considerations:

- Current demand for many services exceeds General Fund capacity to supply
- Starting early helps: Savings in FY2015 go to ending fund balance, helping mitigate expected FY2016 gap.
- During the budget process planned savings were reduced by \$5 million
- Eliminating services will result in personnel layoffs

Options:

- Explore new public safety service delivery models
 - HPD/HFD response to silent alarms
 - HPD accident response
 - Other options being developed
- Others



Cut Health Benefits Costs

- Reduce benefit options with lower cost plan
 - Current wellness model is working to create a healthy workforce, and it is not desirable to impede that
- Share health care costs
 - (Current split is 75/25)
 - 70/30 split = \$20 million citywide
 - 50/50 split = \$83 million citywide
 - Other splits in between
 - (This would create a disproportionate impact on lowest paid employees)



Non-Tax Revenue Options

- Full service cost garbage fee
 - Create Solid Waste Enterprise Department and institute garbage fee. This is the method utilized in other cities to cover cost of solid waste collection, recycling and disposal, unburdening the property tax (Potential of \$85-100 million).
- Increase General Fund fees and charges to cost of service
 - Limited utility due to 2010 fee adjustments (Maximum potential of \$5 million).

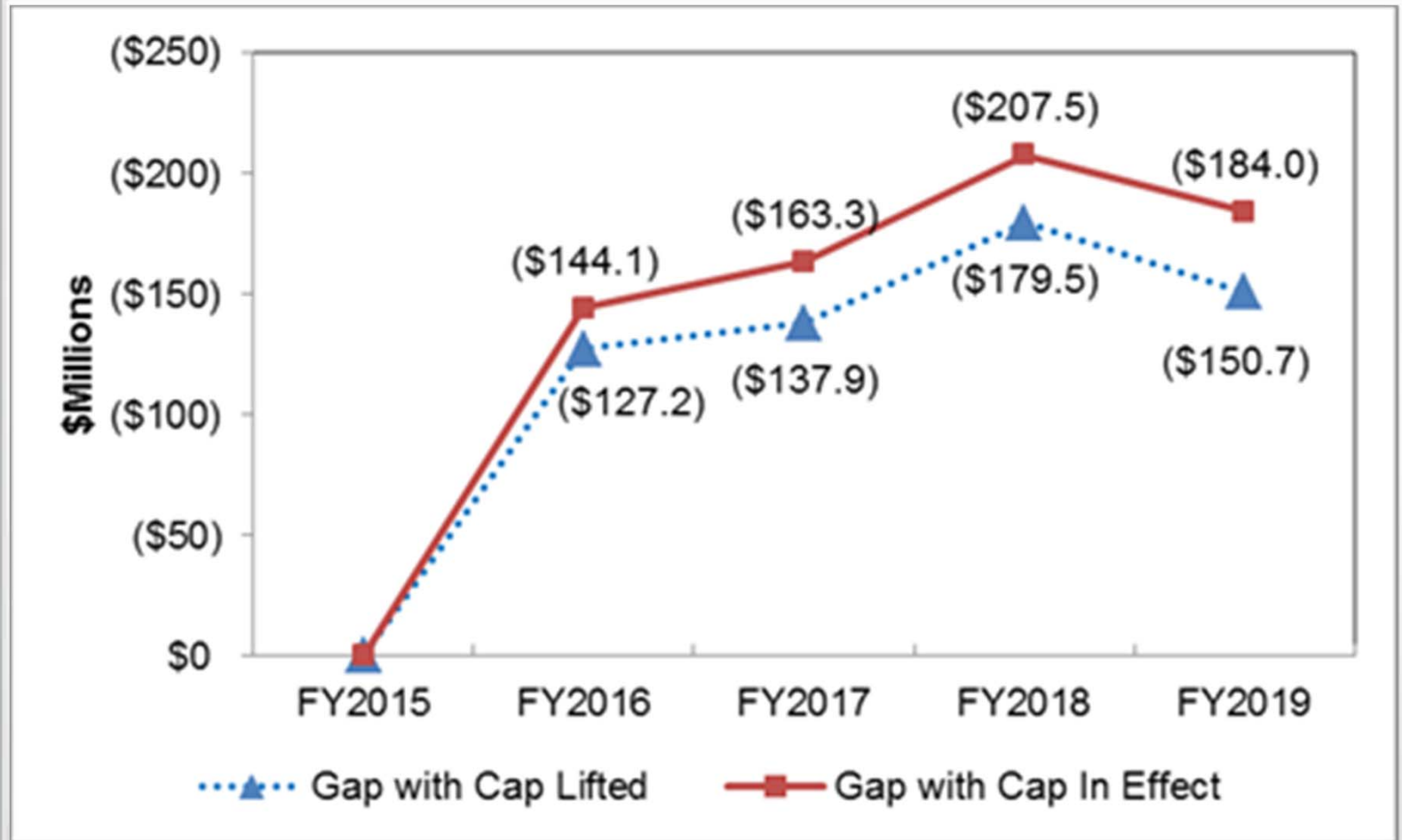


Lifting or Modifying the Property Tax Cap

- Lifting or modifying the cap won't completely solve the problem.
 - Economy appears to be returning to more traditional/slower rate of growth
 - Energy boom is flattening out
 - Employment growth is returning to historic norms of 2-3% annually
- In order to impact FY2016 budget, voter approval is required before FY2016 property tax rate is set in Sept. 2015.
 - Election would have to occur in May 2015 instead of with normal election cycle in November
- Natural growth in property taxes generates about \$17 million more in FY2016 without changes. This will equal approximately \$104 million total for FY2016-2019.



Lifting or Modifying the Property Tax Cap Reduces, But Does not Eliminate, the Gap





Control Rising Pension Costs

- Not a short-term solution
- Continue current litigation to:
 - Obtain non-confidential beneficiary data needed to fully understand plan benefits as administered by HFRRF
 - Challenge constitutionality of the plan imposed by the State
- Continue pressing the State Legislature for changes
- Option to issue pension bonds to mitigate one-time charges adds to the debt burden (will not be proposed by the Administration)



Forward Looking Statements

The statements contained in this presentation and made verbally in conjunction with the presentation that are not purely historical are forward looking statements, including statements regarding the City's expectations, intentions, or strategies regarding the future. Readers and viewers should not place undue reliance on forward looking statements. All forward looking statements in this presentation and made verbally in conjunction with the presentation are based on information available to the City on the date hereof, and the City assumes no obligation to update any such forward looking statements.

The forward looking statements herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or development in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors, and legislative, judicial and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among other things, future economic, competitive, and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the City. Any of such assumptions could be inaccurate and, therefore, there can be no assurance that the forward looking statements included in this presentation and made verbally in conjunction with the presentation would prove to be accurate and may be materially different.

Additionally, pension-related projections or forecasts, including projections of the amount of the UAAL and net pension liability and the amounts of actuarially calculated contributions by the City, constitute "forward-looking" information that reflects the judgment of the City, the boards of the Pension Systems and the actuaries as to the amount of assets that will be required to be accumulated for the payment of future benefits to both active and retired employees. Such judgments are based upon a variety of assumptions concerning future events and circumstances, any one or more of which could prove to be inaccurate and are subject to change in the future. The assumptions underlying the projections are material to the development of the projections, and variations in the assumptions may produce substantially different results. New accounting rules adopted by GASB in June 2012 may result in material changes in the City's financial statements relating to the Pension Systems beginning in Fiscal Years 2014 and 2015, although not in the calculation of the UAAL.

The top section of the slide features a blue background. On the left, there is a close-up of a calculator's keypad with numbers 3 through 0 and symbols like '+', '-', 'x', and '/'. Behind the calculator, there is a faint, glowing grid pattern and some numerical data points. The text 'Finance Department' is positioned on the right side of this section in a black, sans-serif font.

Finance Department

The bottom section of the slide has a light gray background with a subtle, repeating pattern of rectangular shapes, resembling a grid or a window pane. The word 'Appendix' is centered in this section in a large, black, sans-serif font.

Appendix



Five-Year General Fund Forecast Overview

- Forecast begins with the FY2015 Adopted Budget
 - Projected expenditures reflect ongoing operations and current service level provision, legal mandates, staffing for new facilities, contractual escalators, and debt service for capital projects
 - The capital budget for facilities, rolling stock, and information technology is not included
- Highlights growing gap between expected revenues and expenditures at current service levels
 - Need for spending reductions and/or revenue increases to align City's income and expenditures over the next four years
- Slower economic growth predicted at a pace that does not match expected demand growth in City expenses
- Forces driving gap include property tax cap, as well as rising cost of pensions and deferred debt service



Fiscal Year 2015 - Budget Overview

The FY2015 Adopted Budget:

- Reflects strong economic growth
 - Increase of 8.93% in property tax revenue over FY2014, the highest amount in more than a decade, reflecting strong growth in property values in calendar year 2013
 - Increase of 5.4% in sales tax revenue, \$34 million higher than FY2014 estimates, but expecting slower growth
- Increases funding for pensions, health benefits and contractual pay raises
- Meets City standards for financial reserves
 - Full designation of \$20 million in the Rainy Day Fund
 - Unassigned ending fund balance ratio in General Fund above the preferred 7.5% ratio to expenditures before debt service



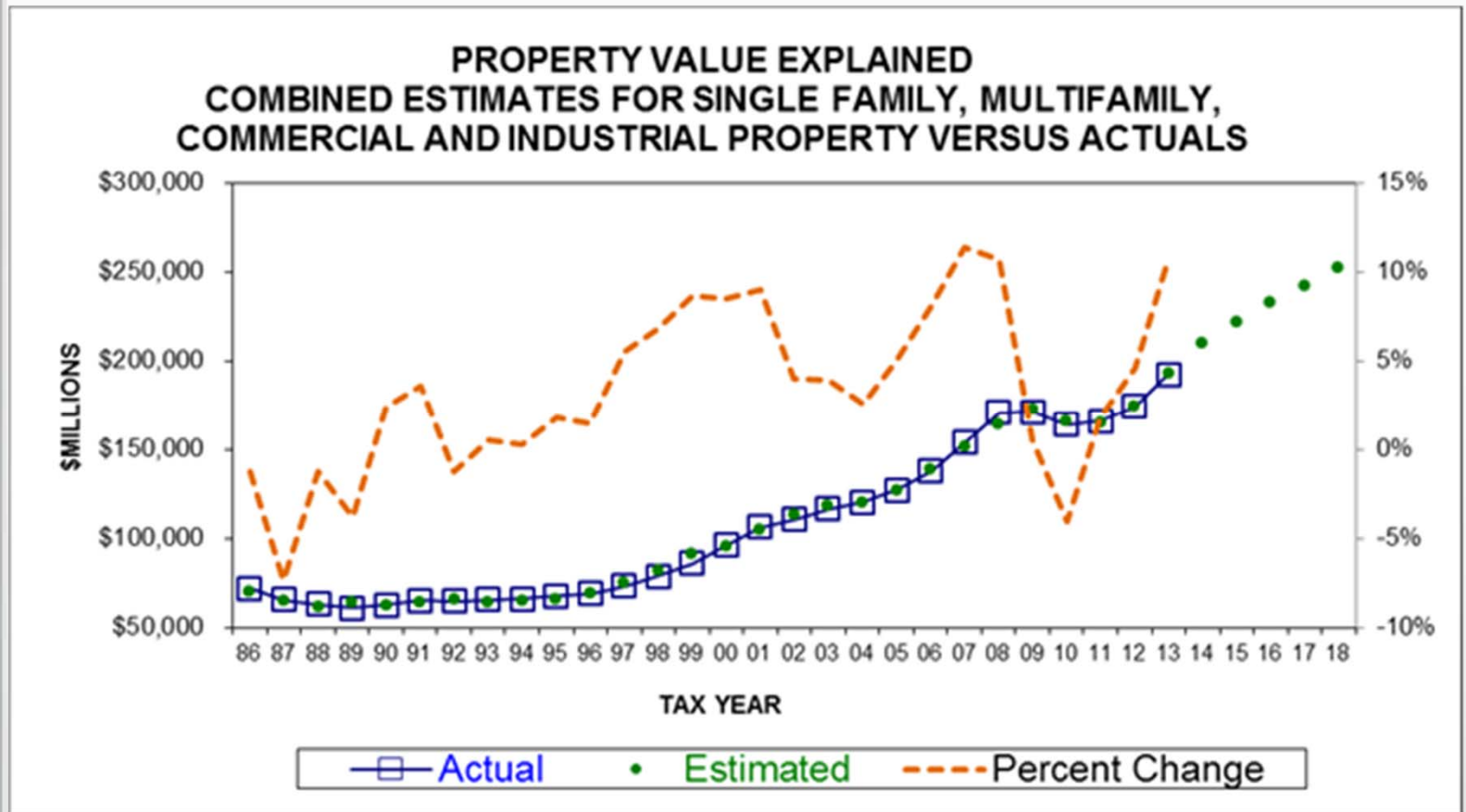
Economic Growth Assumptions

Indicator	CALENDAR YEAR				
	2013 Actuals	2014	2015	2016	2017
Population (City-Pct Chg)	1.62%	1.58%	1.58%	1.58%	1.58%
Employment (MSA-Pct Chg)	3.51%	3.20%	2.60%	2.70%	2.70%
Upstream Energy Employment (MSA-Pct Chg)	5.45%	3.20%	2.60%	2.70%	2.70%
Single Family New Construction (\$Millions)	\$1,302.3	\$1,250.0	\$1,000.0	\$1,000.0	\$1,000.0
Change in Home Prices	10.07%	6.00%	4.00%	3.50%	3.50%
World Oil Consumption (Pct Chg)	0.51%	1.30%	1.60%	1.50%	1.50%
Exports to Mexico (Pct Chg)	4.71%	6.00%	7.00%	8.00%	9.00%

- Figures for 2014 and thereafter are estimates
- Population based on annual growth used in cap calculation
- Employment growth based on Houston forecast by Dr. Bill Gilmer (Director, Institute for Regional Forecasting at UH C.T. Bauer College of Business)
- Single family home prices follow historical trend after 2013 increases
- Home construction driven by employment and population growth
- Energy and trade indicators based on consensus forecasts and current trends



Property Tax Growth Expected to Continue, But Will Not Bridge the Funding Gap



- New property tax model uses historic data to improve accuracy of revenue predictions



Economic Growth Needed to Cover Entire Gap: Not Going to Happen

Indicator	CALENDAR YEAR				
	2013 Actuals	2014	2015	2016	2017
Population (City-Pct Chg))	1.62%	1.86%	2.16%	4.01%	6.05%
Employment (MSA-Pct Chg)	3.51%	10.00%	10.00%	8.00%	8.00%
Upstream Energy Employment (MSA-Pct Chg)	5.45%	10.00%	10.00%	8.00%	8.00%
Single Family New Construction (\$Millions)	\$1,302.3	\$1,250.0	\$1,250.0	\$1,250.0	\$1,250.0
Change in Home Prices	10.07%	10.00%	4.00%	3.50%	3.50%
World Oil Consumption (Pct Chg)	0.51%	2.00%	2.00%	2.00%	2.00%
Exports to Mexico (Pct Chg)	4.71%	10.00%	7.00%	8.00%	9.00%

- An unprecedented surge in population and employment growth must occur beginning immediately in order to influence the 2015 property tax roll and FY 2016 budget
- Home construction has to hold at current (historically high) levels
- World economy sees a mini-boom causing worldwide oil demand to grow at almost twice its historical rate (1.1%)
- Rapid recovery in Mexico's now-sluggish economy causes US exports to Mexico to grow for four years at nearly double current rates