

# Mayor's Budget Message Accompanying Proposed Budget



## CITY OF HOUSTON

**Bill White**

Mayor

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May 19, 2004

To: Honorable Members of the City Council, City Controller and Citizens of Houston:

I am pleased to submit the proposed budget for the fiscal year which begins July 1, 2004, and ends June 30, 2005 (FY '05).

It is a performance-based budget in which Public Safety will take the highest priority, with the largest new investments. It streamlines City government to deliver more services within a disciplined spending plan.

This budget includes a plan for performance-based compensation and a plan for greater security for municipal pensions so we have a productive, competitive workforce. It provides property tax relief and no increase in property tax rates. Also, the budget contains continued investment in mobility, including funding to finish the improved timing of traffic signals.

### **Putting Public Safety First**

Public Safety expenditures will exceed 60 percent of the City's General Fund Budget, minus debt service costs. In fact, the combined expenditures for Police, Fire and EMS, will increase by \$59 million in FY '05. In all likelihood, this is the largest such increase in the City's history.

In the Police budget, we will maintain the number of officers available to respond to calls for service.

The benefits of reduced payroll associated with numerous retirements of senior officers will not be realized in FY '05 because of the effect of accumulated vacation, sick pay and termination pay. Therefore, this will place a premium on efficient use of Police resources while the final pay impact of these retirements works its way through the system.

### **Streamlining City Government**

City government can deliver more public services within disciplined budgets.

For example, the Building services Department will maintain the same number of City buildings and properties with 63 fewer positions. This involves eliminating duplication of overhead functions, eliminating some mid-level managers and flattening the organization.

Also, by the end of FY '05, there will be 36 City Libraries open, up from the preceding year. This will provide citizens with a record number of Libraries. We will accomplish this without compromising the budget for materials acquisition by transferring non-core functions (such as mowing of Library lawns) and through efficient use of volunteers.

### **Funding Performance-Based Compensation and Secure Employee Pensions**

An administrative order creates a band around the average base pay for each pay grade, with the adjustments based on employee performance. In May the City will complete performance evaluations for each municipal employee.

The budget then makes \$12.4 million available for municipal employee pay adjustments and Directors are being encouraged to find further sources for incentive pay within their overall budgets.

In addition, a record amount of new assets will be contributed to the Municipal Employee Pension System, increasing the value of the system's assets by more than 20 percent, conditioned on reasonable changes and future benefit formulas. This will reduce the Municipal Pension funding gap by more than half.

### **Property Tax Relief**

The budget provides for property tax relief equivalent to lowering the limit on valuation increases from 10 percent to 7 percent. It also implements an increased homestead exemption for seniors.

The budget does not increase the property tax rate from last year's rate. And, total property tax revenues in this budget are projected to increase by less than 2 percent. This is far less than the average annual increase over the last decade.

### **Continued Investments to Improve Mobility**

The budget funds completion of the project to improve timing of traffic signals. It continues to invest significant funding for street maintenance. And it funds street and road projects in the CIP.

### **Prior Groundwork**

Prior actions by my Administration and the City Council have laid the groundwork for this balanced budget proposal.

We balanced the FY 2004 Budget, which was out of balance by some \$7 million, primarily through cost reductions.

With enhanced financial discipline, Moody's Investor Services upgraded the City of Houston's largest debt – the water and sewer debt – in May 2004. This saves taxpayers millions of dollars in interest payments.

Further, because of the City's water/sewer/drainage infrastructure program, approved by the Council in April, the City now has a substantial dedicated fund to reduce flooding through drainage improvements. Funding for the operation and maintenance of the water, wastewater and drainage system is in place.

With passage of Proposition 1 on May 15, the City can meet and confer with the Pension Boards to make pensions more secure without raising taxes or cutting services.

Also, spiraling health benefit costs have been shared with employees, avoiding the need for cuts in services.

I want to acknowledge the professionalism and dedication of our department heads and City staff members who helped us through the process of crafting this budget proposal. We've used responsible, realistic honest accounting and kept our eyes on the goal of delivering more and better services for the dollars spent. We've emphasized Public Safety and mobility. And we've tried to encourage our City workforce and give them incentives to continue working with assurances about safe, secure and fair benefits.

It is a performance-based budget. I believe Houstonians deserve no less than our best performance at City Hall.

Sincerely,

A handwritten signature in black ink that reads "Bill White". The signature is written in a cursive, flowing style.

Bill White  
Mayor



# CITY OF HOUSTON

## Finance and Administration

**Bill White**

Mayor

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October 1, 2004

Honorable Mayor, Members of City Council, and City Controller and the Citizens of Houston:

I am pleased to transmit herewith the adopted budget for the City for the fiscal year beginning July 1, 2004 and ending June 30, 2005 (FY 05). This document includes budgets for the City's General Fund, the three major enterprise funds (Aviation, Combined Utility System, and Convention and Entertainment Facilities) as well as many smaller Special Purpose Funds, Revolving Funds, and Internal Service Funds.

The FY 05 budget is the first to be prepared under the leadership of Mayor Bill White, who assumed office in January, 2004. Mayor White's priorities are set out in his letter that accompanied the proposed budget, which was sent to City Council on May 19, 2004, pursuant to the requirements of the City Charter. The purpose of this letter is to describe the budget as adopted unanimously by the Houston City Council on June 23, 2004, after several weeks of collaborative debate and amendment. The full list of amendments is provided as an attachment to this document.

The adopted budget for FY 05 is balanced as required by City Charter and State law. Balancing the FY 05 budget in a responsible manner was challenging, especially given the magnitude of the financial needs of the municipal employee and police officers pension systems. The magnitude of these problems were only fully understood in FY 04. This budget is the first budget that addresses these problems and is the first step in a dialog with the trustees of the two plans. This dialog has already resulted in an acceptable compromise with both the Houston Municipal Employees Pension System and the Houston Police Officers Pension System that recognizes the legitimate needs of the employees and the constraints imposed by our citizens' ability to bear additional taxation.

This budget is also the first to recognize the significant steps taken by the Mayor and City Council to reorganize the City's water, wastewater and drainage effort into a forward-looking plan to attack what many believe is the City's most significant problem - protection from flooding. The adopted budget for the Combined Utility System, which includes the first water and sewer rate increase since 1994, will allow the City to fund system improvements in the amount of at least \$300 million per year plus make important improvements in our drainage infrastructure. Here we are "racing against the clock" as the unpredictable Gulf Coast weather patterns will undoubtedly hold future surprises.

## **Planning Context**

The City of Houston conducts its annual budget process within an overall planning framework that includes multiple elements that transcend the current fiscal year. Typically, larger departments will have created and gained approval for multi-year master plans (examples include master plans for the Houston Parks Department, Houston Public Library, and city-wide drainage) that establish longer term goals and form the framework for individual budget requests. Integrated with these multi-year master plans is the City's five year Capital Improvement Program (CIP) and five year Technology Improvement Program (TIP) which implement the annual spending in these capital-intensive areas.

Prior to the beginning of each budget process, the City Council, acting through its Fiscal Affairs and Management Initiatives Committee, is presented with a five year forecast of revenues and expenditures. This forecast highlights longer term problems that may be developing as a result of revenue trends that may not favor the City. A key example of this planning element is the recognition that technological changes are making substantial unfavorable changes in the City's revenue structure in the area of telecommunications.

In a strong-mayor form of government, each Mayor has individual priorities that require modifications to the longer-term planning process. An example occurred when Mayor White redirected resources to solve specific mobility problems within weeks of assuming office. National priorities, such as homeland security concerns can also have a dramatic effect on longer term planning efforts.

## **FY 05 Budget Overview**

Overall, the adopted budget includes expenditures of \$2.588 billion, which is \$135.9 million (5.54%) above the adopted FY 04 budget. The largest single contributor to this increase is the Combined Utility System, since the approved rate increase becomes effective with this budget. The Aviation Department also contributed significantly to the increase, as debt service for major expansions of the City's airport hubs begins to impact the budget. Table I provides budget summaries for each of the City's operating funds.

## **General Fund**

The City's General Fund is its largest fund, and supports the majority of the basic service infrastructure of the City, such as police and fire protection, health and human services, garbage collection and street repair. The largest single source of revenue for the General Fund is the property tax, while the second largest source is a sales tax. Together, property tax and sales tax revenue produce about 67% of the total revenue for the General Fund. As will be discussed more fully below, the Mayor and City Council have recognized the growing burden of the property tax by indicating they intend to lower the rate by one half cent per one hundred dollar assessed valuation when the tax rate is adopted in September.

The General Fund budget, by department and by revenue source, is shown in summary form on Page II-2. The total General Fund expenditure budget is \$1.455 billion, which is \$48 million (3.4%) above the FY04 budget. This incorporates the funding for the contractual pay raise resulting from the 2001 Meet and Confer Agreement with our commissioned police officers. As can be seen from the General Fund Summary, most departments are expected to operate at resource levels below their FY 04 budget levels.

## **General Fund Revenue Highlights**

Overview - The revenues available to support the operations of the General Fund are described in detail beginning on page II-4 of this budget. The budget was prepared with conservative revenue projections based on ranges provided by experts such as the Harris County Appraisal District and University of Houston Economics Department. The much-anticipated return of sales tax growth has begun in recent months. While we hope this will continue throughout our new fiscal year, the City's experience in FY 03 with rapidly diminishing sales tax has introduced an additional measure of conservatism into budgetary projections.

Property Tax Rate - City Council has indicated its intention to set the FY 05 property tax rate at 65 cents per hundred dollar assessed valuation, a decrease of one half cent from the prior year. (Tax rates are adopted in September for all jurisdictions in Texas, without regard to their individual fiscal years). In addition, the adopted budget contains revenue estimates that incorporate our ongoing plan to increase the exemption for seniors and disabled citizens by 10% for each of the next four fiscal years. The revenue from property taxation is expected to be \$671.6 million, which is 1.9% above the revenue received during FY 04.

Sales Tax - The FY 05 adopted budget calls for a return to healthy sales tax growth, after year-to-year declines in FY 03 and part of FY 04. The strength of the local economy is resulting in a prediction that sales tax revenues will increase in FY 05 by 5.3 % over the amount received in FY 04, plus an amount added for special districts that have petitioned the City to share one cent of sales tax through Limited Purpose Annexations.

Use of Metro Funds - The FY 05 budget includes the use of an additional \$10 million in funds received from Metro (the City's mass transit authority), which we will apply toward costs of street maintenance and repair. The Mayor's agenda for FY 05 calls for continued aggressive street resurfacing, traffic signalization, and traffic studies.

Telephone Franchise Fees - The deterioration of our revenue from telephone franchise fees has been dramatic, and is projected to continue into FY 05, despite the best efforts of our legal and legislative teams. This is a national problem, stemming largely from fundamental technological changes which are moving telecommunications away from companies that are legally within our regulatory framework. The City Council and the Administration have indicated that they intend to aggressively guard our revenue stream with the help of Senator Hutchison and other members of Congress, the Texas Municipal League, the U.S. Conference of Mayors, and others.

## **General Fund Expenditure Highlights**

Overview- This document contains detailed information on each City department's budget, including a comparison with prior years. In addition, each department has identified specific items or highlights which are of particular interest in FY 05. The following paragraphs highlight some of the most significant items found in this budget.

Staffing Levels - Table II demonstrates the level of FTE staffing provided in this budget, compared to past years. The concept of FTE or Full Time Equivalent is a method for comparing funded level of effort in a consistent manner. As can be seen, staffing in the General fund is generally lower for most departments in FY 05 except in the category of classified firefighters. Although Table II indicates no funding for a police cadet class in FY 05, it is anticipated that funding will be shifted from a contingency line item to allow one class of 70 cadets to begin early in 2005. This change is the result of a budget amendment which was implemented in the week

following the formal adoption of the budget, based on additional property tax revenues having been forecast by the Harris County Appraisal District.

Compensation - The adopted budget fully funds the contractual increases in classified police salaries that resulted from Meet and Confer agreements executed in FY 01 and modified in 03. In addition, a compensation increase allowance for municipal employees has been included in each City fund, based on the Mayor's request and the City Council's concurrence that the City needs such an allowance to encourage and motivate City staff.

Pension Systems - The City has three pension plans for its employees and two of them (Municipal Employees Pension System and Police Officers Pension System) have been characterized by rapidly deteriorating funding ratios. Although the poor market performance between 2000 and 2002 are partially responsible for this situation, the largest cause relates to benefit improvements supported by the City in 2001 which were based on actuarial projections which have proven to substantially underestimate the City's required contribution. As mentioned above, the full extent of the under-funding was only fully revealed by actuarial studies conducted in FY 04.

Pension contributions may be made either through payroll contributions in the operating budgets of the various funds, or through the issuance of tax-supported pension obligation bonds which are repaid from the General Debt Service Fund. The General Debt Service Fund receives a portion of the property tax revenue and smaller amounts from other funds.

The transfer to the General Debt Service Fund found in the General Government Account (see Page VII-3), includes additional amounts needed to fund debt service on a modest pension obligation bond. The agreement reached with the trustees of the Houston Municipal Employees Pension System after the budget was adopted, includes the requirement to issue \$33 million in pension obligation bonds during FY 05, an amount well within the assumption made at the time the budget was adopted. Additional bonding capacity is available to support additional contributions required as a result of the completed negotiations with the Houston Police Officers Pension System.

Public Safety - This budget funds classes for 330 fire cadets and maintains the policy of four firefighters per apparatus. With this policy in place, it is financially advantageous to increase the cadre of commissioned firefighters, since each new employee offsets the need for an overtime employee.

The budget includes funding for one additional class of police cadets, as mentioned above. Staffing for our Police Department is expected to continue to be a challenge as officers retire and the City continues to grow. The City's new Police Chief is developing alternative strategies to address this problem.

Budget Reductions - In developing the proposed budget, Mayor White established budget targets which were generally less than prior years (without regard to increasing health care costs) and challenged his department heads to plan a more efficient, more responsive operation. The compensation contingency discussed above encourages departments to reward their most productive employees and provides them with a means of doing so.

### **General Fund Ending Balance**

The adopted budget includes an ending balance of \$106.6 which is approximately equal to the expected ending balance for FY 04. This balance, including the \$20 million Rainy Day Fund, represents 8.5% of expenditures other than debt service, a prudent measure that exceeds the City's policy guideline.

## **Enterprise Funds**

Introduction - The City has three major enterprise funds. The Aviation Fund and the Convention and Entertainment Facilities Fund operate as City Departments. The Combined Utility Fund is managed as a portion of the Public Works and Engineering Department, which also manages General Fund activities such as street maintenance and traffic signalization.

Aviation - The Aviation Department is responsible for two major hub airports (George Bush Intercontinental and William P. Hobby), both of which have experienced substantial facility expansions in the last five years. The terrorist events of September 11, 2001 have slowed air travel nationwide although the improvements at the City's major airports have proceeded in anticipation of a rebound in air traffic and continued robust growth in the Houston metropolitan area.

The Aviation Department budget of \$346.6 million is increased from the FY 04 budget by approximately \$78 million (29%), with the majority of the increase in the debt service category. This is the result of the major improvements that have been financed over the last several years becoming operational.

The Aviation Department budget also includes mandated security improvements, much of which is provided by the Houston Police Department. The General Fund is reimbursed for the cost of these services.

Combined Utility System - The Combined Utility System was created in late FY 04 as a result of a major refinancing of the outstanding debt of the City's Water and Wastewater System. The FY 05 budget is the first budget to reflect these changes. The purpose of the financial restructuring was to modernize bond covenants that had been in place for a decade, restrict the ability to remove excess funds from the system for non-system purposes, and to provide for additional investment in drainage improvements. This restructuring was accomplished with a present value savings and without compromising the system's strong bond rating.

The planning for the \$3 billion restructuring began over two years ago and the results, coupled with the first water and sewer rate increase since 1994, have established a long term framework for protecting and enhancing the City's water, sewer and drainage infrastructure. A discussion of the Combined Utility System begins on Page VIII-36.

Convention and Entertainment Facilities - The City's Convention and Entertainment Facilities Department budget is not substantially changed from FY 04 (see Page VIII-25). The effects of the 2001 terrorist events have been felt through out the tourism industry, with relative stability restored in FY 04 and modest growth predicted for FY 05.

The department took a lead role in planning and hosting the National Football League Super Bowl in FY 04 and the Major League Baseball All-Star Game early in FY 05. Both of these events were executed flawlessly in the opinion of many observers and brought significant favorable attention to Houston as a world class sports venue.

## **Capital Improvement Program**

The City conducts its annual Capital Improvement Program process on a different schedule than its operating budget process, resulting in a the approval of a five year plan within the first three months of the fiscal year. Because the plan is a five-year "evergreen" plan, and individual projects are brought to City Council for approval prior to beginning construction, no discontinuity is experienced.

At the time of this letter, the proposed CIP has been presented to City Council, and is consistent with the financial plan included in this document.

### **Conclusion**

The budget contained in this document addresses the difficult problems of governing and improving a growing City with urban problems ranging from traffic congestion to public safety and amenities. Major improvements have been made in the financial stability of the pension systems and the important infrastructure related to water and sewer and drainage.

This budget, and importantly, the constructive spirit that characterizes the relationship among the Mayor, the City Council and the City Controller, provides a framework for positive and forward-looking planning and problem solving.

Judy Gray Johnson  
Director