CITY OF HOUSTON

Finance and Administration
Department

Interoffice

Correspondence

To: Lee P. Brown, Mayor
Members of the City Council

From: Philip B. Scheps
Director

Date: November 27, 2002

Subject: **OCTOBER MONTHLY FINANCIAL AND OPERATIONS REPORT**

Background

The purpose of this memorandum is to discuss the City's interim financial results as of October 31, 2002, representing four months of FY03. Preliminary FY02 results have been shown in the column headed FY2002 "Preliminary CAFR". The table on page 7 summarizes the full year projections as compared to the current budget for the General Fund.

Beginning Balance

The FY03 budget was developed assuming that the FY02 ending balance would be $85.2 million. The Controller's FY2002 Preliminary CAFR includes an ending balance of $87.9 million, or an increase of $2.7 million. The primary reason for this increase is the positive results from delinquent tax collections, which raised the property tax revenue final amount to $623.1 million, an amount which is $ 1.1 million below the original budget.

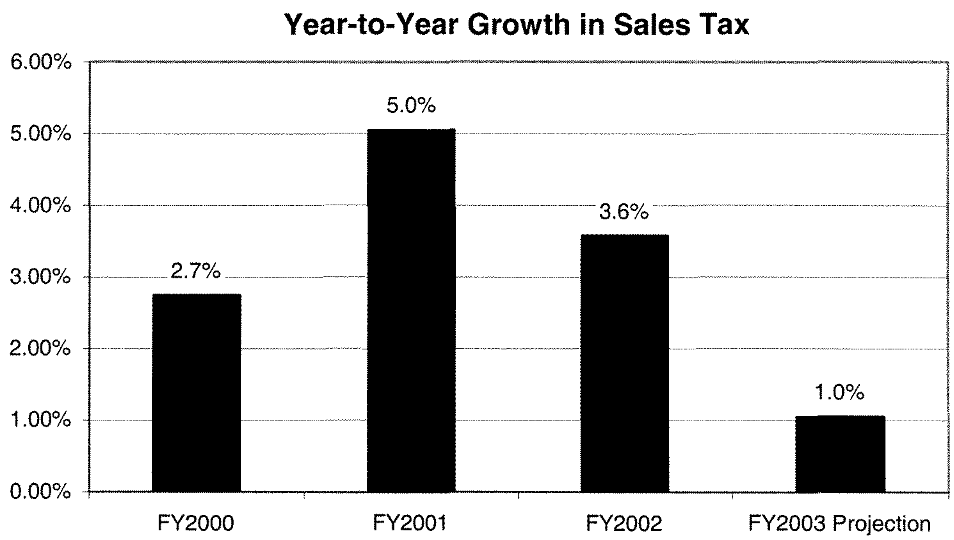
General Fund Revenue

The projected total General Fund revenue is $1.402 billion, which includes "pass-through" amounts of $6 million related to airport overtime and $1 million related to CIP-reimbursed positions. **This amount is approximately $15.4 million below budget**. The main contributors to this below-budget projection are: property tax ($6.7 million, or 1%), sales tax ($6 million, see below)) and municipal courts ($5 million) offset by smaller increase in other areas. The following paragraphs discuss the primary changes from budget.

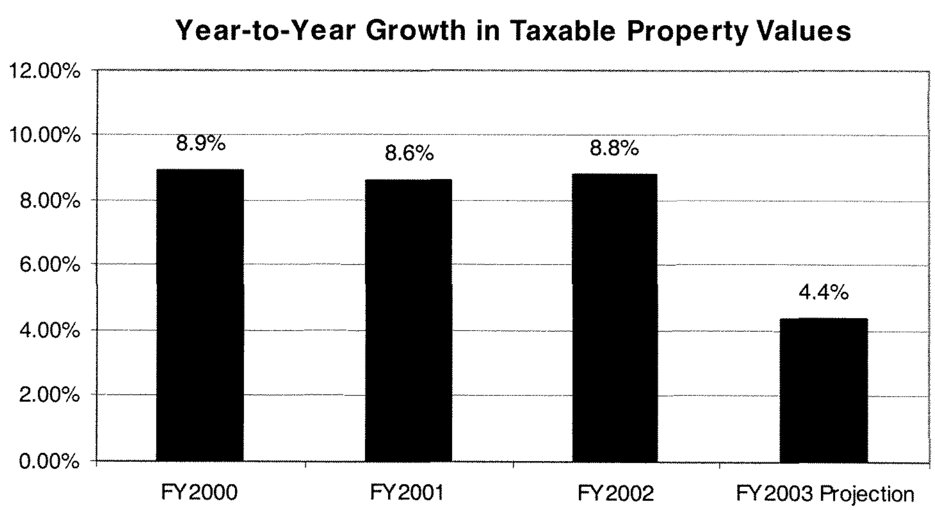
Sales Tax - the monthly check received from the State Comptroller's Office in November was significantly less than the check received one year previously. In particular, the amount was 18% less than the 2001 check with all factors considered, and 14% less on a current basis. This large and unexpected decrease led to a series of conversations with Dr. Barton Smith, who has now revised his model projections downward. A decrease of $6 million is shown in the current MFOR.

Dr. Smith has isolated three effects in the model that account for the decrease: (a) inflation, (b) rig count, and, (c) job growth, all of which have been smaller than originally projected. In particular, the inflation rate in Houston has been under 1%, and this translates into a $3 million decrease in revenue, since sales tax is tied to the prices paid for goods. The assumption built into the model was approximately 2%.

If the current projections are correct, the sales tax growth for FY03, not counting contributions from the limited purpose annexations, will be only slightly above 1%, further reinforcing the unexpected weakening of the economy. The graphs below compare property tax and sales tax year-to-year changes with the estimates for the current year.



Note: Does not include revenue for limited purpose annexations.



<u>Municipal Courts Revenue</u> - this report reflects no change in the revenue from Municipal Courts fines and forfeitures, although trends appear to be improving. The contracts with the delinquent collection firm, the address provider for parking tickets, and the data base related to drivers licenses are now in place. A warrant sweep is scheduled for mid-December. Additional performance measures related to Municipal Courts are included in the trend section of this report.

Ambulance Revenue - a check for $1.1 million has been received from Medicare as a result of our appeal of the audit findings that resulted in withholding on our payments in FY02. In essence, the hearing officer agreed with us on substantially all of the findings. The City will net $950,000 of this amount. Since ACS returned their fee when we paid Medicare, they are entitled to their fee on the reimbursement.

General Fund Expenditures

The City is in the midst of an effort to substantially reduce expenditures, primarily as a result of negative revenue surprises in sales tax and property tax. This report reflects work in progress toward that goal.

Because the pay raise was budgeted centrally and has not been formally distributed to departments, the progress toward balancing the budget is somewhat difficult to see in the standard accounting tables contained in the MFOR. Accordingly, Attachment C to this letter provides a table that makes the department-by-department savings easier to understand. In particular, this table first allocates the pay raise money to the departments (something that will happen formally at mid-year) and then demonstrates the budget reductions that are estimated to date. **The effort to balance the budget is ongoing, and the estimates shown do not represent the final amounts.**

The method used was to allocate savings targets to departments differentially, with staff departments assuming larger reductions than service departments. Department heads were asked to report consequences of the reduction, and the Mayor is making final decisions based on these consequences.

It should be recalled that the IT budget was reduced by $1.6 million because of the projected savings resulting from SimHouston. This causes the IT department to appear over budget while all other departments are under budget by varying degrees.

As shown on Attachment C, total savings of $16.2 million have been identified. However, $1 million of this amount is "pass-through" savings that are matched by revenue reductions. (The police pass-through savings had already been removed from the budget.) The remaining $15.2 million in savings are "true" savings. Because of the way the budget was constructed, the first $5.5 million of this amount were already accounted for and cannot be used to offset revenue shortfalls. Therefore, $9.7 million in savings has been identified to offset the revenue shortfall, and $5.7 million in savings or revenue increases remains to be identified.

General Fund Ending Balance

The projected ending balance is $97.6 million. This includes the assumption that insurance proceeds will be added to the Rainy Day fund by year-end. The undesignated fund balance is projected to be $74.8 million, which is a decrease of $6 million from the undesignated beginning balance. These values will all improve when the remaining $5.7 million required to achieve a balance is identified.

Enterprise Funds

Convention and Entertainment Facilities - the first quarter of FY03 saw a fairly large decrease in the hotel – motel tax revenue. This decrease (approximately 20% less than the comparable quarter in FY02) was reported in prior MFORs. Second quarter data has now been received, showing a continuation of the pattern, although at reduced amounts. Tax receipts are down from last year approximately 6.5%

Water and Wastewater - For the first four months of the year, water and sewer revenues are 9.5% below budget, with October revenues slightly below budget. As a result, projected revenues for both water and sewer have been reduced by $500 thousand each in October. This now represents a year to date reduction in revenues of $5 million, split evenly between water and sewer revenues.

Aviation - Projected revenues from Landing Area fees is being reduced by $12 million. These revenues represent charges to the airlines for capital improvements made at the airports. The implementation of higher charges at IAH is being delayed and will not be reflected until next year's Landing Area fees are set.

Other Items of Interest

Performance Measures - the trend section of the monthly report has been reorganized to add additional detail in areas which have been historically problematical. In particular, additional detail on municipal courts revenue, ambulance revenue, inter-fund billings, CIP cash flow, and fire staffing has been added.

Debt Management - the City negotiated a refunding of Series 93 D General Obligation bonds, as well as some annexed district debt, on November 20th, , pursuant to permission granted by City Council. The present value savings related to the transaction was $9.7 million, or over 6.3% of the refunding size. The true interest cost of the refunding bonds was 4.1%.

The City Council agenda of December 4th will include the establishment of a commercial paper program for equipment acquisition. This will allow funding of the FY03 budgeted equipment, as approved by City Council or as modified at the time of the appropriation ordinance for the equipment.

Please contact me for additional information.

Philip B. Scheps
Director

c: Sylvia R. Garcia, City Controller
Albert E. Haines, Chief Administrative Officer