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CITY OF HOUSTON

Sylvester Turner
Mayor

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

I am pleased to present the preliminary General Fund budget for the fiscal year which begins July 1, 2016, and ends June 30, 2017 (FY2017). I am not anticipating significant changes, but I stress that these figures are subject to revision given the fact that I am presenting them nearly a month before the formal budget document is to be released. We are able to provide this preliminary budget well ahead of the normal schedule because of the focus my administration has put on our finances since I was elected.

Cost increases, voter imposed revenue limitations, a broken appraisal system and the economic downturn combined to create a $160 million budget shortfall - the largest fiscal challenge the City has faced since before the Great Recession. At $2.3 billion, this budget totals about $82 million less expenditures than the current FY2016 appropriation. This is especially significant when juxtaposed against the $60 million of contractual and mandated cost increases we are forced to cover in FY2017. By bringing all parties to the table to engage in shared sacrifice, we closed the gap, reduced spending and started building the foundation for change that will address the City's structural budget problems. Each City department, the employee unions, the Tax Increment Reinvestment Zones, City Council and various other parties have worked together to identify cost savings and efficiencies while also preserving a healthy fund balance, minimizing employee layoffs and maintaining the critical City services our residents rely on and deserve.

This budget includes the elimination of 54 vacant positions and 30 to 40 layoffs, the majority of which we hope to accomplish through attrition. I made a decision that there would be no significant reductions to park and library operations because they have been hit hard in the past. These departments provide critical services to our most vulnerable populations, especially during hard economic times. It makes no sense to cut them further.

Although there have been cost reductions identified within the police and fire departments, there will be no layoffs of police officers or fire fighters. In fact, we are including funding for an additional police cadet class, for a total of five classes, and looking at ways to streamline operations to get more officers back on the street. The new Turnaround Houston program to help the hard to employ will continue in FY17 and we are putting together an expanded summer jobs program for our youth. I hope Houston's major employers will join in.

This budget was balanced using both recurring and non-recurring initiatives. If non-recurring items had been taken off the table, there would have been drastic cuts in City services and another 1,235 City employees would have lost their jobs. I was not prepared to do that to the residents of this great City or our municipal workforce.

The recurring initiatives mark the start of institutionalizing a new way of running City government. We have streamlined operations, eliminated redundancies and forced greater efficiencies for recurring annual savings of $36.2 million. The TIRZs have agreed to contribute an additional $19.6 million to the General Fund for FY2017 and an equal or larger amount in subsequent years. Yet to come is a new approach for our pension liabilities. Productive discussions are underway with stakeholders and I am committed to having an agreement ready to take to the legislature by the end of this year.

In the past, there has been a desire to tinker with the mayor's budget proposal. I strongly urge that not be the case this year. Even one small change will upset the delicate balance we've achieved as a result of shared sacrifice and put the City at risk for a credit rating downgrade. This budget allows us to plan for the additional fiscal challenges the City will encounter in FY18 while also improving public safety, increasing employment opportunities and meeting the critical needs of the less fortunate in our city. I am asking City Council members not to do anything to change the course we have carefully mapped out.

I look forward to your support.

Sincerely,

Sylvester Turner
Mayor

Forward Looking Statements

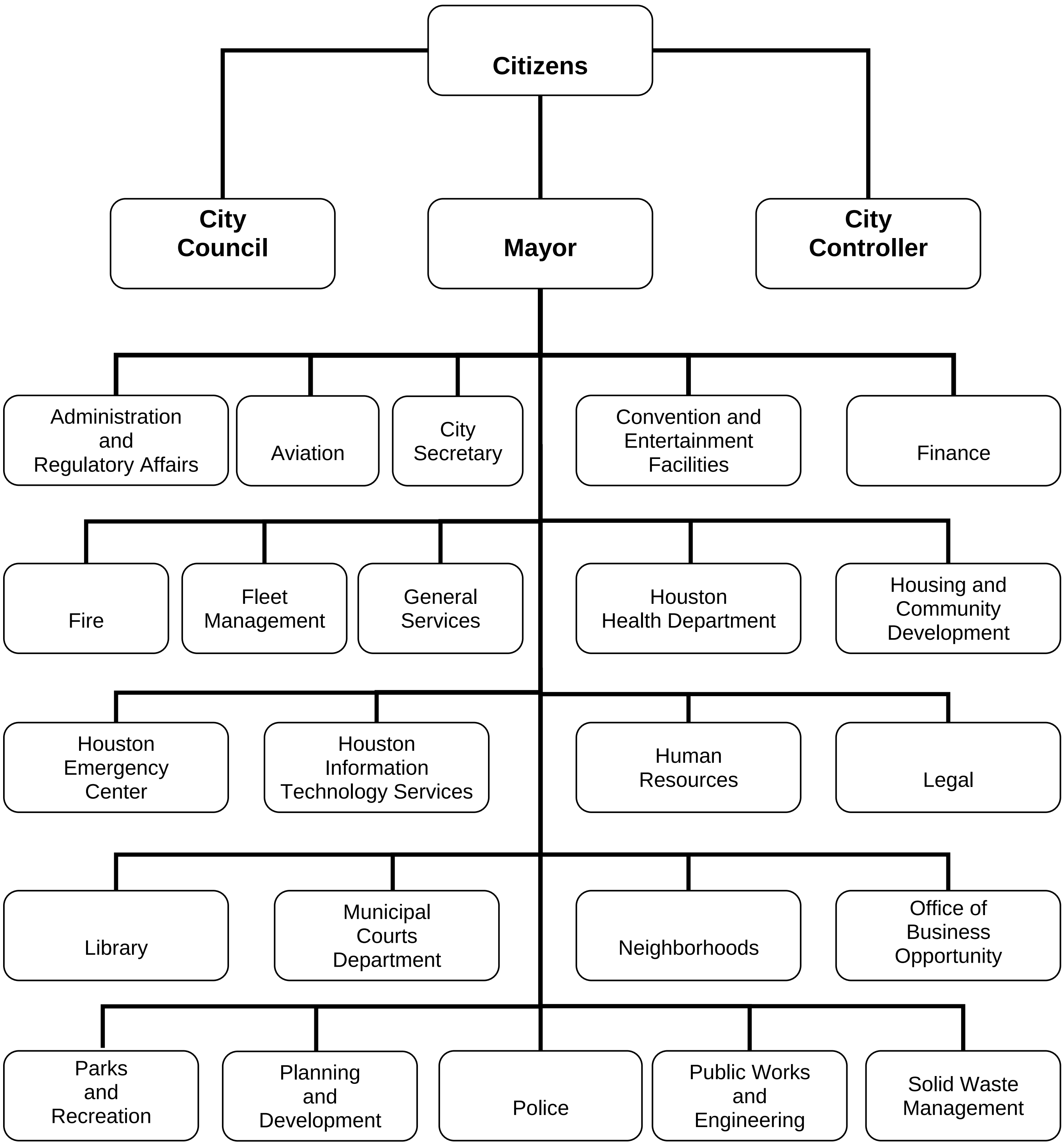
The statements contained in this document that are not purely historical are forward looking statements, including statements regarding the City's expectations, intentions, or strategies regarding the future. Readers and viewers should not place undue reliance on forward looking statements. All forward looking statements in this document and made verbally in conjunction with the release of this document 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 document and made verbally in conjunction with the release of this document 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.

Amounts shown in this document are preliminary amounts and may be subject to change. The FY2017 Proposed Budget is to be released on May 10, 2016.

Organization Chart



Basis of Budgeting and Accounting

In general, the basis of budgeting and the basis of accounting used in the preparation of the City's annual financial report are the same for all governmental funds (general fund, special revenue fund, debt service fund, and capital projects). Revenues and expenditures are budgeted consistent with the City's financial statements, which are prepared in accordance with Generally Accepted Accounting Principles (GAAP) for all governmental funds.

Governmental funds are accounted for on a modified accrual basis. This means that revenues are recognized in the accounting period in which they become available and measurable. Expenditures are recognized in the accounting period in which the fund liability is incurred, with the exception of long-term liabilities. Significant receivables (revenues) and liabilities (expenditures) are recorded in the prior year's budget up to sixty days after fiscal year end if they represent earned income or expenditures as of June 30, the last day of the fiscal year. This includes the cost of employees' time as well as supplies, services, and equipment delivered by June 30.

For enterprise funds, the budgeting and accounting basis are the same except for depreciation and non-current expenses. Enterprise funds are accounted for on a full accrual basis, where revenues and expenses are recorded when they are earned/incurred. Enterprise funds focus on expenses related to maintenance and operations, equipment purchases, and exclude depreciation and other allocations related to income determination. Revenues received and expenses paid for goods and services delivered by June 30 are credited or charged to the current fiscal year's budget.

Encumbrance accounting is used to reserve funds committed to vendors for supplies, services and equipment throughout the year in all funds. However, encumbrances for items not delivered by June 30 are canceled and re-established against the new fiscal year budget for all operating budgets. Encumbrances do not establish expenditures/expenses or liabilities. Appropriations and encumbrances for capital project funds are maintained in effect until they are liquidated.

Reserves

The City's fund balance level has been a critical component of the City's financial management program. Reserves exist in two forms:

- Those specifically created by ordinance, and
- Those maintained as unappropriated or unassigned ending fund balance.

Most of the City's budgetary reserves take the form of ending fund balances and are consequently the result of financial activity as presented in the City's financial statements.

General Fund Reserves

The following table shows the ending unassigned fund balance as well as the actual year-end maintenance and operating costs for preceding fiscal years, the estimated year-end costs for the current fiscal year and the estimated year-end costs for the subsequent fiscal year.

Historical Data FY1997 – FY2017
General Fund Available Fund Balances
($ thousands)

Fiscal year	Unassigned Fund Balance	M&O Expenditures	% of Fund Balance
FY1997	84,105	903,228	9.31%
FY1998	106,856	956,893	11.17%
FY1999	80,409	1,030,235	7.80%
FY2000	66,590	1,064,160	6.26%
FY2001	79,432	1,105,408	7.19%
FY2002	80,335	1,206,160	6.66%
FY2004	88,659	1,235,994	7.17%
FY2005	120,042	1,279,879	9.38%
FY2006	175,832	1,368,746	12.85%
FY2007	234,535	1,459,076	16.07%
FY2008	253,514	1,567,484	16.17%
FY2009	236,275	1,668,700	14.16%
FY2010	165,383	1,676,367	9.87%
FY2011	129,040	1,680,038	7.68%
FY2012	171,677	1,590,044	10.80%
FY2013	202,842	1,705,450	11.89%
FY2014	222,620	1,821,588	12.22%
FY2015 Actual	287,842	1,964,412	14.65%
FY2016 Estimate	196,394	2,026,749	9.69%
FY2017 Estimate	186,712	2,013,465	9.27%

Previous City financial policies adopted by Ordinance 2003-474 required that fund balance as a percentage of expenditures less debt service be 5% or greater, however it was the City's desire to maintain ending fund balance equal to 7.5% of expenditures less debt service.

The City's financial policies were revised and strengthened with adoption of Ordinance 2014-1078. Under the new policies, the City is now required to maintain an ending fund balance equal to at least 7.5% of General Fund expenditures (excluding debt service and transfers for pay-as-you-go capital projects). This went into effect starting FY2016.

Houston Demographics and Economic Conditions

The City of Houston was founded on August 30, 1836, by brothers Augustus Chapman Allen and John Kirby Allen, and named after General Sam Houston. The City of Houston's simple 19th century city seal – the noble locomotive (heralding Houston's spirit of progress) and the humble plow (symbol of the agricultural empire of Texas from which Houston would draw her wealth) – clearly speaks to the roots of Houston's economy and to the visionary leadership of its citizens.

According to the United States Census Bureau, Houston has a total area over 600 square miles comprising of 579.4 square miles of land and 22.3 square miles of water. Houston is the fourth most populous city in the nation with an estimated 2014 population of 2,239,558 (3,502 people per square mile), just behind New York, Los Angeles and Chicago; and is the largest city in the southern U.S. and Texas.

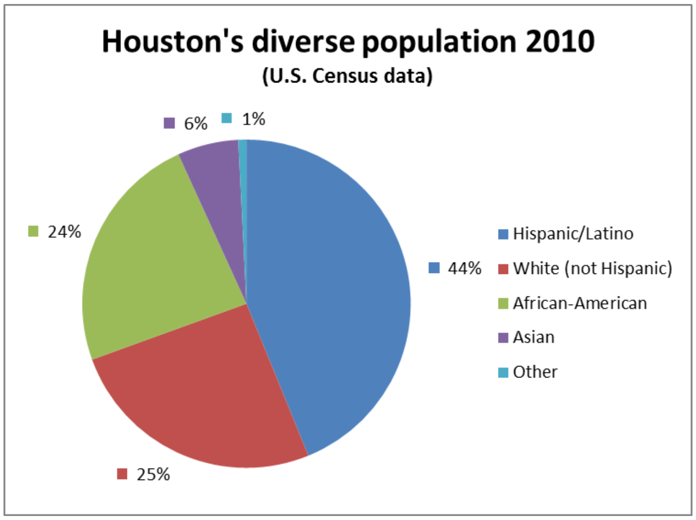
With 6,656,947 inhabitants in 2015, the nine-county Houston-The Woodlands-Sugar Land Metropolitan Statistical Area (MSA) is the nation's fifth most populous metro area. The entire MSA covers more than 10,000 square miles and includes all or part of the Austin, Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, and Waller counties. Houston is the center city of one of the most dynamic urban centers in the United States.

2014 City Population				
New York	Los Angeles	Chicago	Houston	Philadelphia
8,491,079	3,928,864	2,722,389	2,239,558	1,560,297

2015 Metro Area Population	
New York, Newark, Jersey City, NY-NJ-PA	20,182,305
Los Angeles, Long Beach, Anaheim, CA	13,340,068
Chicago, Naperville, Elgin, IL-IN-WI	9,551,031
Dallas, Fort Worth, Arlington, TX	7,102,796
Houston, The Woodlands, Sugar Land, TX	6,656,947
Washington D.C., Arlington, Alexandria, VA-MD-WV	6,097,684
Philadelphia, Camden, Wilmington, PA-NJ-DE-MD	6,069,875

Population growth continues in the city and the metropolitan area: the Houston metro area added 159,083 residents from July 2014 to July 2015, according to U.S. Census data that show the area gaining more population than any other metro area in the nation. Every Houston-area county experienced population growth in 2015, and Harris County led the nation's counties in population growth, adding 90,451 residents (among counties with 250,000 people or more, Fort Bend showed the fastest percentage growth with a 4.3% population increase in one year).

Houston also stands among the nation's most diverse cities, drawing newcomers from around the U.S. and across the world – foreign-born residents accounted for two of every five newcomers to the region in the past five years.



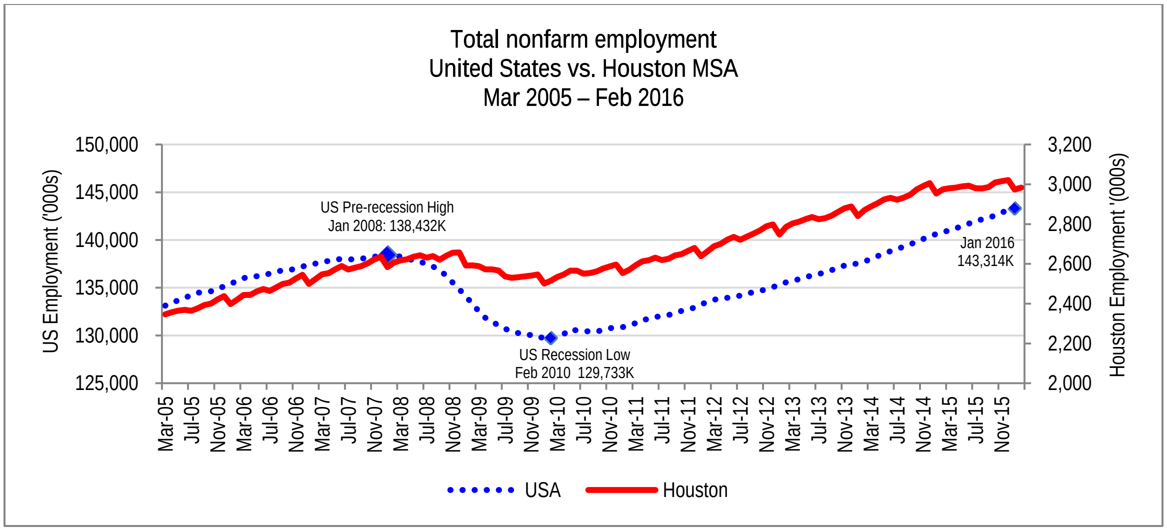
According to the U.S. Census Bureau, as of 2010, Houston's population breakdown by race and ethnicity was as follows: Hispanic or Latino origin 43.8%; White (not Hispanic) 25.6%; African-American 23.7%; Asian 6.0%; American Indian and Alaska Native 0.7%; Native Hawaiian and Pacific Islander 0.1%; and persons of two or more races 3.3%. Additionally, 49.8% of Houston's population is female; 25.9% of all persons are under 18 years of age and 9.0% are over 65 years; 28.3% of all persons are foreign born; and 46.3% of all households speak a language other than English.

While the economy has started to slow, population growth is still likely to continue, albeit at a reduced pace. The region records an annual "natural increase" in population of about 60,000, as births outpace deaths, and this means that even a 50% drop in the number of residents moving to Houston would yield annual population growth of nearly 90,000. The Greater Houston Partnership notes that population growth has been steady over the past 15 years, with the region's population increasing from 3.7 million to 6.6 million and showing few effects from upswings and downturns in oil prices.

ECONOMIC OUTLOOK

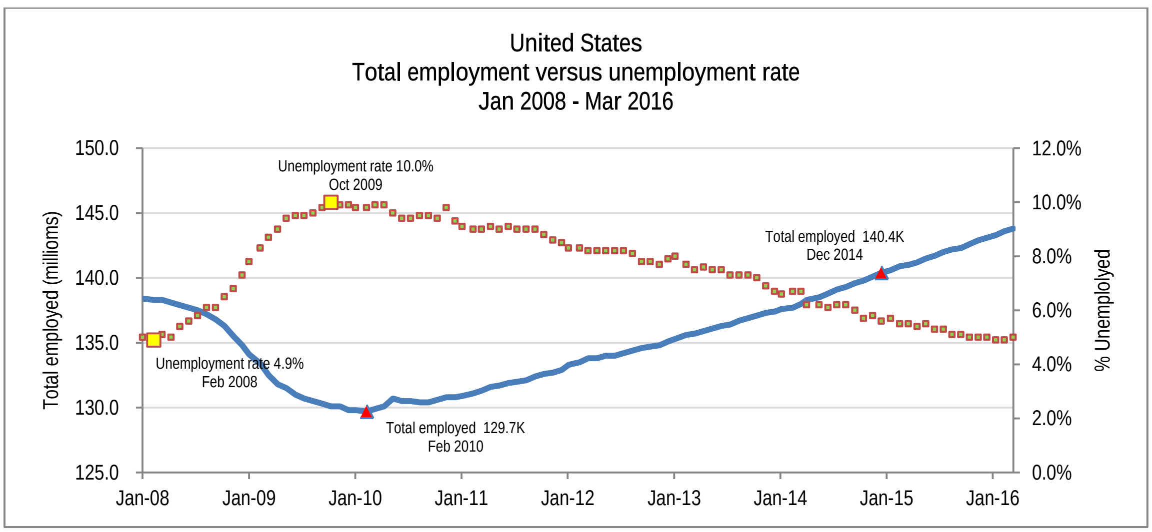
For the fifth time in 35 years, Houston faces economic uncertainty brought on by falling oil prices. Rigs are idled and the City's sales tax revenue has fallen. The Houston Purchasing Managers Index for March 2016 registered 45.9, up from February's 44.5 mark but below the 50-point level required to indicate economic expansion (the index has now signaled economic contraction in Houston for 15 straight months). And construction has slowed as new capacity generates office and multi-family supply that could outstrip demand.

The region's economy remained relatively strong through and following the Great Recession; as indicated in the chart below, Houston never saw the dramatic employment dropoff experienced by much of the U.S. from late 2008 into early 2010. Since that time, the Houston MSA has seen job growth sufficient to keep local employment growth at a pace near that of the nation's employment expansion. However, with the impact of lower oil and gas prices on the upstream energy sector, Houston's employment growth has slowed and is being outpaced by increases in U.S. employment.



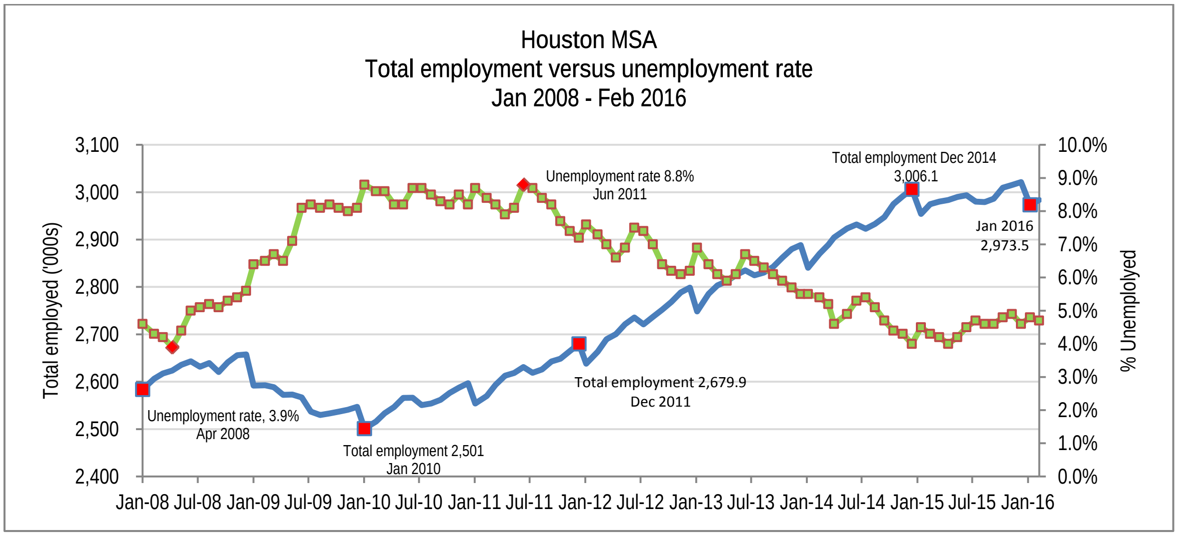
Source: US Census Bureau

Nationally, the slow but steady job growth has moved the nation beyond its pre-recession high of 138.4 million jobs in January 2008. As of March 2016, some six years after the recession low of 129.7 million jobs in February 2010, the U.S. has recovered 14 million jobs with an estimated 143.8 million jobs, easily surpassing the pre-recession highs.



Source: US Census Bureau

Houston's story is quite different: Houston lost only 156,400 jobs from December 2008 to January 2011. The area's recovery was also much more rapid than at the national level, as Houston regained its pre-recession jobs level by December 2011, only 23 months after the low point of the recession. As of December 2014, Houston had gained 326,200 jobs since December 2011. While Houston recovered at a faster pace than the country as a whole, much of that growth was attributable to expansion in energy exploration due to higher oil prices. The lingering downturn in prices has dramatically slowed employment growth in Houston, although the impact is being slightly offset by active construction projects started during the recent building boom and new projects in downstream energy refining that are now more economical with lower energy prices.



Source: US Census Bureau

While initial Texas Workforce Commission data indicated the area created 23,200 jobs in 2015, revisions released in March 2016 reduced the 2015 job-creation total to 15,200, a dramatic drop-off from the 117,800 jobs created in 2014 (the region's third-best year on record for job growth). Job losses tended to occur in sectors more closely tied to the upstream energy industry; the overall gain was driven by an increase of 65,000 jobs in sectors including accommodations and food services; arts and entertainment; construction; finance and insurance; government and health care.

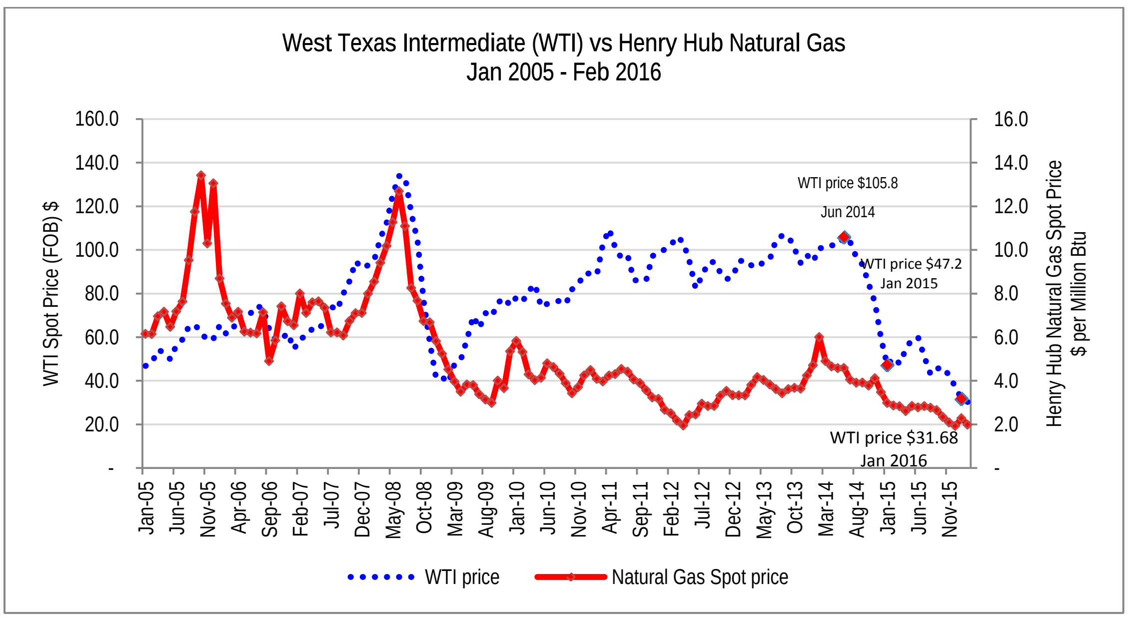
As job growth slows (weighed down by a market in which the nation is showing its lowest count of working oil rigs in more than half a century), there are still reasons for optimism. Looking ahead, area economists cite several reasons to believe that Houston will successfully weather this newest storm. For one, oil downturns are typically linked to a national recession; this is not the case at present, and continued strength in the U.S. and global economies helps Houston (demand for consumer goods drives demand for plastics and chemicals, and many Houston companies are impacted by business trends occurring far from this metro area).

Additionally, Houston's well-documented economic diversification of the past few decades means that as people are laid off from jobs at struggling upstream energy firms, many are able to transfer their skills in areas like finance, human resources, or the law to other employers in sectors like downstream energy, health care or education. Meanwhile, some $50 billion in construction and expansion at refineries and chemical plants to the east of Houston represents one of the largest investments ever in manufacturing capacity along the Gulf Coast. Furthermore, the planned expansion of the Panama Canal will open new doors for area manufacturers wishing to ship to, or bring components in from, Asia.

ENERGY

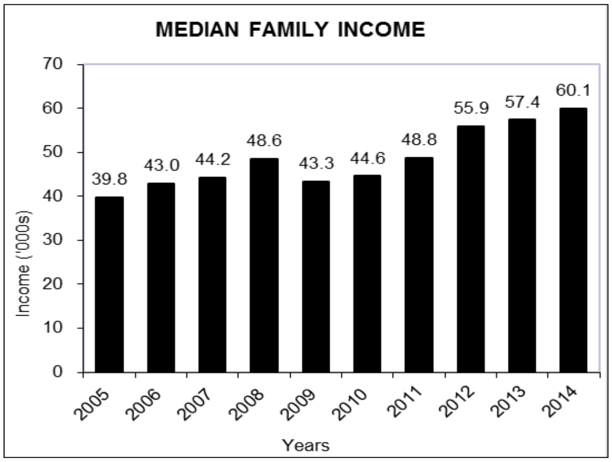
Houston remains the internationally recognized global energy capital, and as such can suffer material economic impacts when oil prices slump. After achieving a high of nearly $106 in June of 2014, oil tumbled to $31.68/barrel in January 2016, a price point not seen since March 2009. This is having an impact on job growth in Houston, as Houston holds a substantial portion of the nation's jobs in oil and gas extraction. Partially offsetting this impact are the nine refineries in Houston that process more than 2.3 million barrels of crude oil per day (approximately half of the state's total production). Lower oil and gas prices translate to lower costs for the inputs that refiners and many other manufacturers in the Houston area use, which can translate into higher profits and more employment related to refining and manufacturing.

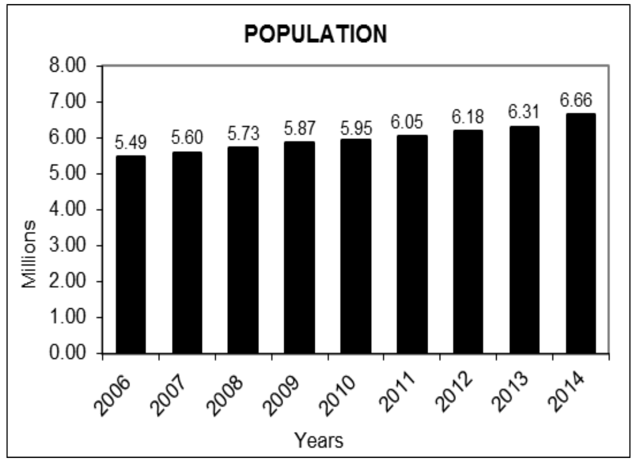
As of April, the Energy Information Administration (EIA) is forecasting West Texas Intermediate (WTI) will approach an average of $35/barrel in 2016 and a further appreciation in 2017 prices to more than $40/barrel. Based on this forecast, local economists say Houston should remain relatively strong in the near term, although a price rebound will be needed at some point to compensate for lost jobs and related economic activity as construction at refineries and chemical plants along the Texas Gulf Coast slows in the next year or two. Should oil prices hold to current projections and remain around $40/barrel, or even increase slightly through the remainder of 2016, Houston is likely to navigate this most recent economic challenge in relative health. Given the volatility of oil prices and projections though, the City would do well to prepare for prices below these levels.

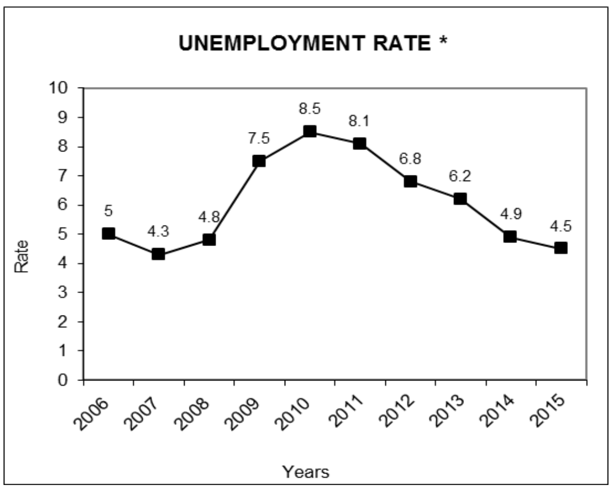


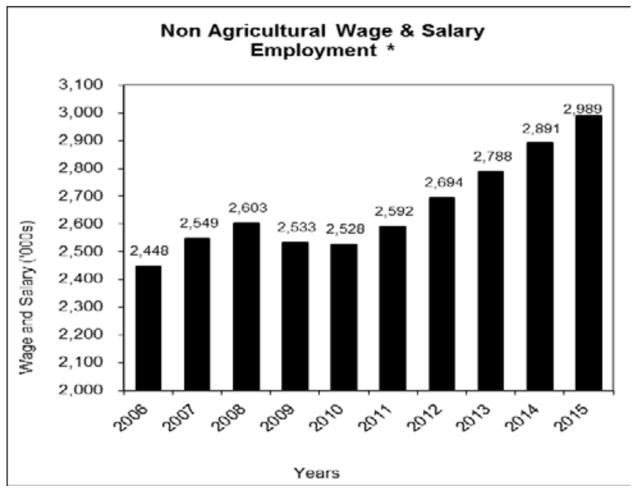
Source: US Energy Information Administration

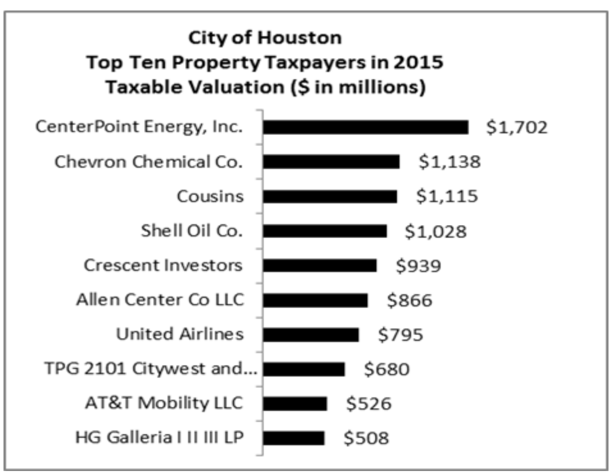
HOUSTON MSA AT A GLANCE

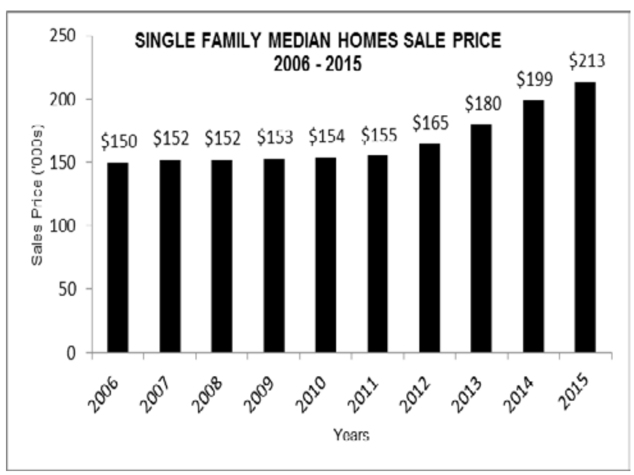










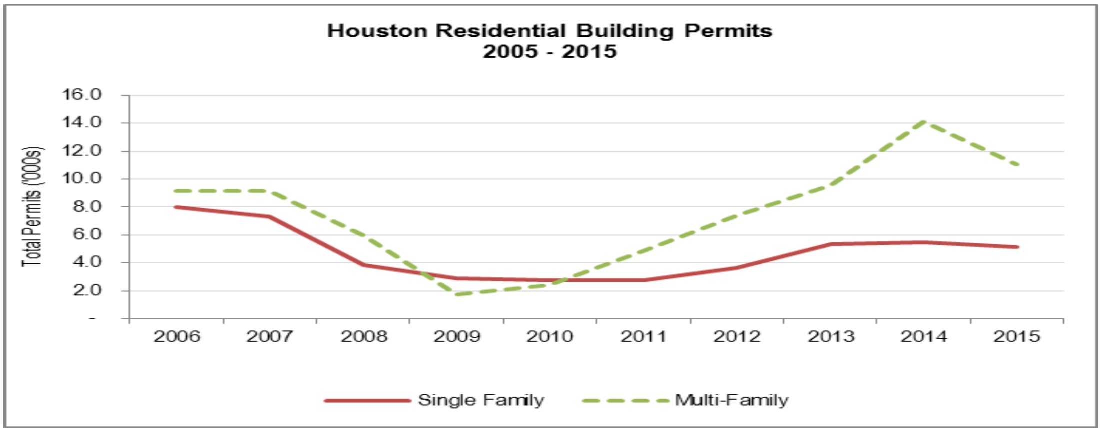


** Not Seasonally Adjusted*

Sources: Greater Houston Partnership, US Bureau of Economic Analysis, US Bureau of Labor Statistics, Harris County Appraisal District

CONSTRUCTION AND REAL ESTATE

The City of Houston issued approximately 16,000 single and multi-family residential permits in 2015, 17% less than in the previous year. The slowdown continues: total building permits in January and February 2016 were down approximately 30% from prior-year totals. The $7.8 billion 12-month total value for Houston building permits as of February 2016 was down from the $8.9 billion in the 12-months ending in February 2015, which the Greater Houston Partnership cites as Houston's historic peak for permit activity. With expansion and construction in various industries, the 2015 non-residential construction permits dropped by nearly 22% compared to prior year. Projections are for a surplus of multi-family and office space capacity after initiation of numerous projects in 2014 and 2015.



Source: City of Houston

Single Family Housing

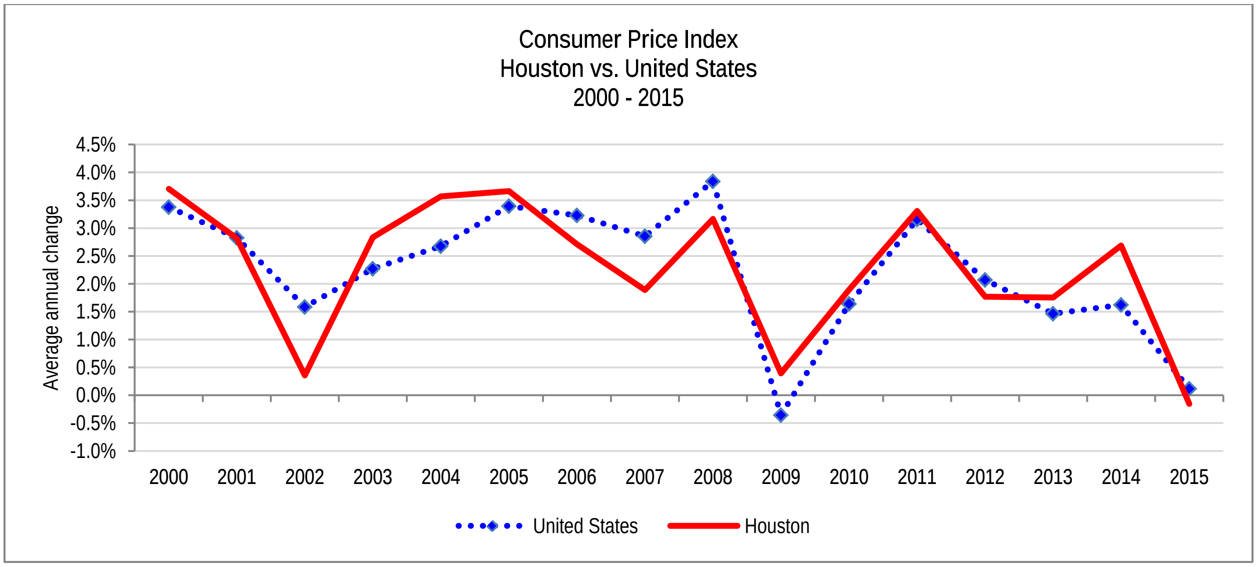
The five-year trend represented in the chart below illustrates the vitality of the Houston housing market during the recent employment boom. Sales in 2015 dropped slightly from 2014's record performance, but total dollar volume held virtually constant as the average sales price increased from $270,182 to $280,290. The report from the Houston Association of Realtors (covering March 2016) highlights positive sales in mid-range homes and increasing inventory as evidence that the Houston real estate market "demonstrated more sustainable conditions." The report shows 2016 home sales running 1% ahead of the 2015 year-to-date pace, with single-family inventory levels climbing from a 2.8-month supply to 3.6 months. It also notes that Houston's inventory remains less than the national supply of 4.4 months' inventory, and points to continued population growth as a mitigating factor against the potential negative effects of energy industry layoffs.

SUMMARY OF HOUSTON RESIDENTIAL SALES ACTIVITY					
	2015	**2014**	**2013**	**2012**	**2011**
Total Sales	88,764	91,439	88,069	74,116	63,606
Total dollar volume	**$23,559,111,514**	**$23,553,542,859**	**$20,891,392,084**	**$16,040,186,637**	**$13,012,903,352**
Single-family sales	73,724	75,535	73,232	62,374	53,592
Average sales price	$280,290	$270,182	$248,591	$225,330	$213,723
Median sales price	$212,000	$199,000	$180,000	$164,500	$155,000

Source: Har.com

COST OF LIVING AND INFLATION

A significant reason for Houston's sustained growth is its lower cost of living. Houston prices, as measured by the Consumer Price Index (CPI), dropped by 0.2% in 2015 compared to the national increase of 0.1%. Houston's overall average CPI for 2015 was 213.1 versus 237.0 nationally, the result of which, is that Houston residents have a cost of living that is approximately 10% less than the national average.



Source: US Bureau of Labor and Statistics

The cost of consumer goods and services, as measured by the Consumer Price Index for All Urban Consumers (CPI-U) for Houston, trended higher than the national average for 2013 and 2014 as evidenced in the chart above, before turning downward in 2015. With oil and gas prices on the decline through the latter half of 2014 and much of 2015, Houston's Consumer Price Index responded with a slight decrease. However, indications through early 2016 are that inflation is returning to the area, as increasing housing costs and a slight rise in food prices offset cheaper motor fuel and household energy. U.S. Bureau of Labor Statistics data show consumer prices in the metro area rising 2% from February 2015 to February 2016, which the Greater Houston Partnership notes is the largest annual increase since late 2014.

Sources:

- Harris County Appraisal District
- The Greater Houston Partnership (Special Thanks to Patrick Jankowski)
- Houston Association of Realtors
- University of Houston Center for Public Policy
- National Association of Realtors Quarterly Report
- City of Houston
- US Bureau of Labor Statistics
- US Census Bureau
- US Bureau of Economic Analysis
- Federal Reserve Bank of Dallas – Houston Branch
- US Government Energy Information Administration
- University of Houston Institute for Regional Forecasting, C.T. Bauer College of Business (Special Thanks to Dr. Bill Gilmer)

Budgetary Challenges

The City is required by state law to adopt a balanced budget. When the City's current expenditures exceed current revenues, that deficit is commonly referred to as the "gap" or "shortfall." These are typically the result of lower revenues than projected and/or increasing expenditures. Each year, the City presents the five-year financial forecast to provide a preliminary estimate of what the upcoming fiscal year will look like. It becomes the basis for the City to take necessary actions to close potential or projected funding gaps in order to balance the following year's budget.

Having weathered the Great Recession of 2008 and now contending with the effects of low oil prices, Houston faces continued budget challenges. Combined with a voter-imposed limitation on property tax revenues and rising pension obligations, the volatile economy presents difficulties as the City serves a still-growing population. This problem manifests in the gap.

As seen in Exhibit 1 below, every City budget since FY2010 has projected a funding gap to be balanced with reserves; looking at the adopted surplus/shortfalls in the past seven years, projected fund balance utilization in balancing the budget ranges from approximately $3,000 to $86 million. This is in part the result of conservative budgeting. In four of the past seven years, the City ended the year with surplus funds that were returned to fund balance as the "mini-boom" generated revenues in excess of cautious projections. With the increasing property values during those four years, the City finally reached the Proposition 1 ad valorem tax revenue cap in FY2015.

The major issue the City is currently facing is the structural balance between revenue and spending. While the City's adopted budget is always balanced, current revenues may not be sufficient to support current expenditures. This shortfall generates a projected structural imbalance that is corrected through the use of financial reserves. As suggested earlier, although the City's past seven budgets have all projected a funding gap, the City's conservative budgeting approach combined with a strong economy has yielded to year-end surpluses in four of the six years from FY2010 to FY2015, with FY2016 anticipated to show a shortfall. Work is in progress to achieve recurring structural balance in the City's budget and stop the dependency on drawing down fund balance; this will offer increased protection from economic volatility and will align with the City's financial policies

The forecasted FY2017 funding gap is the largest seen so far this decade, as FY2016 sales taxes and property taxes are projected to finish the year well below budgeted levels. Sales tax receipts are slumping, while property tax receipts are impacted by successful protests of property tax appraisals as well as the property tax revenue cap. However, a number of strategic initiatives are being put in place or are anticipated to address this situation, and it is anticipated that fund balance drawdown will be kept at $10 million.

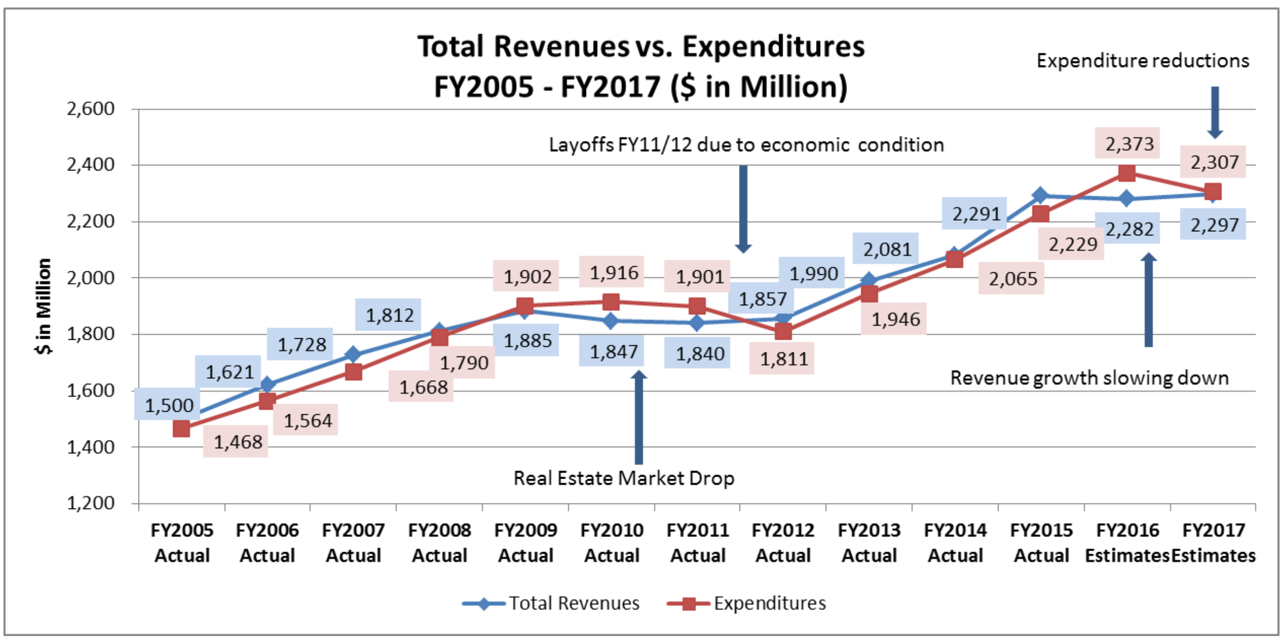
Exhibit 1 – Budgetary Shortfalls

($ in thousands)

	Revenues			Expenditures			Surplus/(Shortfalls)		
	Forecast [1]	Adopted	Actual/ *Estimates*	Forecast [1]	Adopted	Actual/ *Estimates*	Forecast [1]	Adopted	Actual/ *Estimates*
FY2010	1,948,349	1,883,305	1,847,353	2,002,354	1,933,996	1,916,387	(54,005)	(50,691)	(69,034)
FY2011	1,925,035	1,841,776	1,840,055	1,977,877	1,895,691	1,900,876	(52,842)	(53,915)	(60,821)
FY2012	1,821,922	1,827,995	1,857,342	1,912,309	1,827,998	1,810,551	(90,387)	(3)	46,791
FY2013	1,861,551	1,922,868	1,990,456	1,873,840	1,947,897	1,945,653	(12,289)	(25,029)	44,803
FY2014	1,987,762	2,037,289	2,081,459	2,041,539	2,071,197	2,065,401	(53,777)	(33,908)	16,058
FY2015	2,120,698	2,210,910	2,291,146	2,201,764	2,259,370	2,228,912	(81,066)	(48,460)	62,234
FY2016	2,288,820	2,305,376	*2,281,753*	2,430,569	2,391,253	*2,372,749*	(141,749)	(85,877)	*(90,996)*
FY2017 [2]	2,264,557	*2,296,621*	*N/A*	2,424,220	*2,306,621*	*N/A*	(159,663)	(10,000)	*N/A*

Note:
1. Forecasts amount is based on prior years' five-year forecasts presented to City Council.
2. FY2017 forecast amount is revised from prior year's presentation to reflect the drop in sales tax revenues.
3. These figures do not include full funding of pension obligations.

Exhibit 2 – Total Revenues and Expenditures (both recurring and non-recurring)

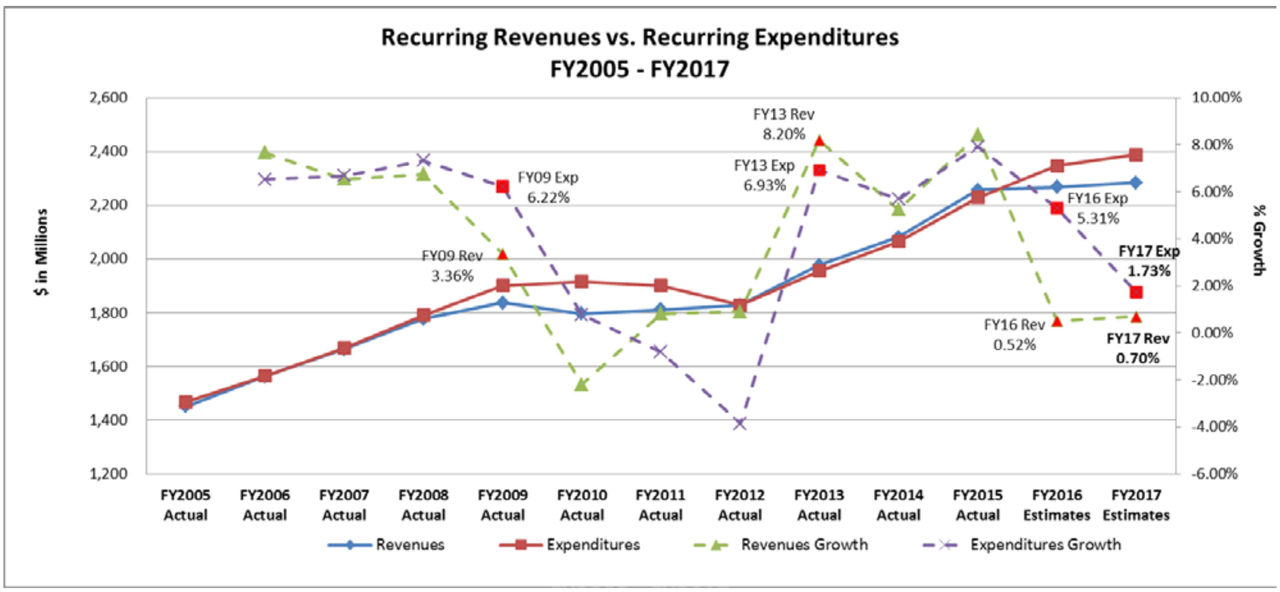


** Please note that the expenditures shown in Exhibit 2 do not include full funding of the unfunded liabilities.*

Exhibit 2 above shows the City's response to revenue drops from FY2009 to FY2011, and as projected from FY2016 to FY2017. At the outset of this decade, the City responded with belt-tightening steps including layoffs in FY2011 and FY2012. As revenues began to rebound, expenditures followed suit as the City's population continued to grow. Though various (largely one-time/non-recurring) measures have kept the City's budget in balance each year, FY2017 will see new expenditure reductions to accommodate a significant slowdown in revenue growth.

While Exhibit 2 reflects all revenues and expenditures (including non-recurring items), the chart below demonstrates that matching recurring revenues and recurring expenditures remains a challenge. As seen in Exhibit 3, beginning in FY2009, following the economic downturn in 2008, the recurring revenues growth was lower than expenditures growth (note that this chart shows only *recurring* revenues and expenditures, and does not include one-time income or outlays). The City changed course and adjusted expenditures downward to compensate. But the problem presented itself again in FY2016, and the chart below indicates a potential trend toward greater structural imbalance, as recurring expenditures start to move upward and away from relatively flat recurring revenues. To achieve financial stability and comply with the City's financial policies, this imbalance must be addressed.

Exhibit 3 – Recurring Revenues and Expenditures



($ in millions)	FY2005 Actual	FY2006 Actual	FY2007 Actual	FY2008 Actual	FY2009 Actual	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Actual	FY2015 Actual	FY2016 Estimate	FY2017 Estimate
Recurring Revenues	$ 1,451	1,562	1,665	1,777	1,837	1,796	1,811	1,828	1,978	2,081	2,257	2,268	2,284
Recurring Expenditures	$ 1,468	1,564	1,668	1,790	1,902	1,916	1,901	1,828	1,954	2,065	2,229	2,347	2,388
Revenues Growth (%)		**7.7%**	**6.5%**	**6.8%**	**3.4%**	**-2.2%**	**0.8%**	**0.9%**	**8.2%**	**5.3%**	**8.4%**	**0.5%**	**0.7%**
Expenditures Growth (%)		**6.5%**	**6.7%**	**7.3%**	**6.2%**	**0.8%**	**-0.8%**	**-3.9%**	**6.9%**	**5.7%**	**7.9%**	**5.3%**	**1.7%**

City Initiatives: Stabilizing the Budget in a New Downturn

As lower oil prices over the past 18 months signaled economic challenges, the City has responded with expenditure reductions intended to cushion the economy's anticipated effects on City revenue as indicated in Exhibit 4 below.

Exhibit 4 – FY2015/16 Budget vs. Actual/Estimates

($ in thousands)	FY2015			FY2016		
	Adopted Budget	Actual	Variance	Adopted Budget	Estimates	Variance
Revenues	2,210,910	2,291,146	80,236	2,305,376	2,281,753	(23,622)
Expenditures	2,259,370	2,228,912	(30,458)	2,391,254	2,372,749	(18,505)
Surplus/(Shortfall)	***(48,460)***	***62,234***	***110,694***	***(85,878)***	***(90,996)***	***(5,117)***

In FY2015, compared to the adopted budget, City of Houston managed to add $111 million surplus in fund balance to ensure future ending fund balance will be above the minimum 7.5% of expenditures less debt/PAYGO. This consisted of $80 million additional revenues and $30 million expenditures savings.

In FY2016, the impact of the economy and falling oil prices finally showed its effects on the City's sales tax revenue, currently estimated at $636.3 million, 7.6% below the budget. Additionally, with the increasing tax refunds from prior years' litigation of contested property tax appraisals, the City's property tax is estimated at $1.09 billion, 1.9% below the budget. The total revenue shortfall from FY2016 budget is at $23.6 million. Whereas conservative revenue projections have helped yield year-end surpluses in prior years, FY2016's large revenue drop negates expenditure savings and yields a remaining shortfall.

The current situation has been mitigated to some extent by cost reduction initiatives undertaken in FY2016 of $18.5 million (net of other increases), shown in Exhibit 4. These included a slowdown in hiring and identification of efficiencies that have reduced City spending below budgeted levels; where savings were projected, budgets were reduced accordingly and savings were directed to fund balance.

Upon taking office in January 2016, the new administration took a number of steps to tighten spending. Executive Order 1-53, issued in January, calls for a series of new policies and procedures to improve the City's financial and performance management. These include an increased emphasis on outcomes in budget decision-making (program- or performance-based budgeting); greater scrutiny of spending proposals; long-range financial planning; greater focus on goal-setting and monitoring of progress toward those goals; and more transparency with regard to communication on fiscal matters. An administrative policy explicating these high-level commitments is to be released by the end of April.

The administration also introduced a new Staffing Efficiency Assessment process (requiring justification to post and fill positions that are not front-line service delivery roles), and has effectively limited hiring to those critical front-line roles. Additional improvements have been achieved with limited staffing cutbacks (as noted in the Mayor's budget letter, the goal is to achieve these primarily via attrition and elimination of vacant positions), and the savings identification and budget capture efforts noted above. Exhibit 5 shows the budget initiatives in FY2015 and FY2016, and Exhibit 6 shows reduction initiatives by department. It is important to note these savings initiatives will not tie to the expenditure variance on Exhibit 4, as other costs have partially offset these savings.

Exhibit 5 – FY2015/16 Budget Initiatives

FY2015 ($ in thousands)	Revenues	Expenditures	Total Initiatives
Initiatives			
One-time Land Sales	$ 23,437	$ -	$ 23,437
Cost Savings Initiatives	-	18,510	18,510
Vacancy Savings	-	3,677	3,677
Total Initiatives FY2015	**$ 23,437**	**$ 22,187**	**$ 45,624**
FY2016 ($ in thousands)			
Initiatives			
Cost Savings Initiatives	-	17,078	17,078
Vacancy Savings	-	6,431	6,431
Total Initiatives FY2016	**$ -**	**$ 23,510**	**$ 23,510**
Total Initiatives FY2015-16	**$ 23,437**	**$ 45,697**	**$ 69,134**

Exhibit 6 – FY2015/16 General Fund Expenditures Reduction Initiatives by Department

($ in thousands)

	FY2015		FY2016		Total
Department Name	**Reduction Initiatives**	**Vacancy Savings**	**Reduction Initiatives**	**Vacancy Savings**	**Reduction Initiatives**
Administration and Regulatory Affairs	$ 856	$ -	$ 244	$ 178	**$ 1,278**
City Council	-	-	-	-	**-**
City Secretary	19	-	-	79	**98**
City Controller	89	-	-	48	**137**
Finance Department	85	171	410	471	**1,137**
Fire Department	2,442	178	5,291	123	**8,034**
General Services	78	-	309	161	**548**
Houston Health Department	435	-	161	802	**1,398**
Housing & Community Development	7	-	101	70	**178**
Houston Emergency Center	-	-	2,000	-	**2,000**
Human Resources	20	60	49	59	**187**
Houston Information Technology Services	433	1,000	17	1,024	**2,474**
Legal	443	748	394	173	**1,757**
Library	537	450	240	69	**1,297**
Mayor's Office	49	-	186	-	**235**
Municipal Courts Department	420	-	336	-	**756**
Department of Neighborhoods	61	70	90	121	**341**
Office of Business Opportunity	30	-	32	34	**96**
Parks and Recreation	1,259	600	913	1,034	**3,806**
Planning & Development	129	400	140	-	**669**
Police Department	10,181	-	4,525	980	**15,686**
Public Works & Engineering	29	-	-	171	**200**
Solid Waste Management	449	-	1,641	835	**2,925**
General Government	459	-	-	-	**459**
Total Budget Initiatives FY15/16	**$ 18,510**	**$ 3,677**	**$ 17,078**	**$ 6,431**	**$ 45,697**

Closing the FY2017 Gap

As noted before, expenditure reduction initiatives began early in FY2016 to mitigate the effects of expected lower-than-anticipated revenues due to the drop in oil prices. The City continues to develop initiatives to improve the General Fund's fiscal stability, primarily via identification of efficiencies and opportunities for expenditure reductions. These are reflected in the $25.8 million expenditure reduction below; limited revenue increases will be utilized in some instances as indicated in the table below.

Exhibit 7 – FY2017 Budget Initiatives

ALL FIGURES ARE PRELIMINARY AND SUBJECT TO CHANGE

($ in thousands)		
Additional Revenues		
TIRZ - Municipal Service Fees Revenue [1]	$ 19,564	Recurring
One-Time Land Sale	12,500	Non-Recurring
Total Additional Revenues	**32,064**	
Expenditures Reductions		
Debt Prepayment from Building Inspection Fund [2]	23,544	Non-Recurring
Debt Refinancing - resulting reduction for the following:		
Debt Service Transfers [3]	31,849	Non-Recurring
ReBuild Houston Transfers according to City Charter [4]	13,467	Non-Recurring
Debt & PAYGO Expenditures Reduction Subtotal	**68,860**	
Council District Service Fund	8,250	Recurring
Department Expenditure Reduction [5]	25,789	Recurring
Service Chargeback Reduction to General Fund	2,200	Recurring
Proposed HPOPS Deferred Contribution [6]	12,500	Non-Recurring
Other than Debt/PAYGO Reduction Subtotal	**48,739**	
Total Expenditures Reduction	**117,599**	
Fund Balance Drawdown	**10,000**	
Total Gap Closed	**$ 159,663**	

Notes:

1. TIRZ Municipal Service Fees will increase to match service costs generated by the TIRZs
2. Debt Prepayment of General Obligation Debt on the 1002 Washington Permitting Center from the Building Inspection Fund went to debt service fund balance in FY2016. This prepayment will be used to offset General Fund debt service increase in FY2017. The General Fund will assume $23.5 million of 1002 Washington debt service going forward.
3. Debt Refinancing savings from 2016 Public Improvement Bond refunding transaction.
4. Captured Revenues Transfer to the Dedicated Drainage Street and Renewal Fund will be made according to ReBuild Houston capital improvement projects.
5. Department Expenditure Reduction in General Fund by Departments can be seen in Exhibit 8.
6. The City has proposed to HPOPS a contribution deferral in lieu of a $12.5 million interest in the 1200 Travis Building owned by the City.

Exhibit 8 – FY2017 General Fund Department Reduction

($ in thousands)

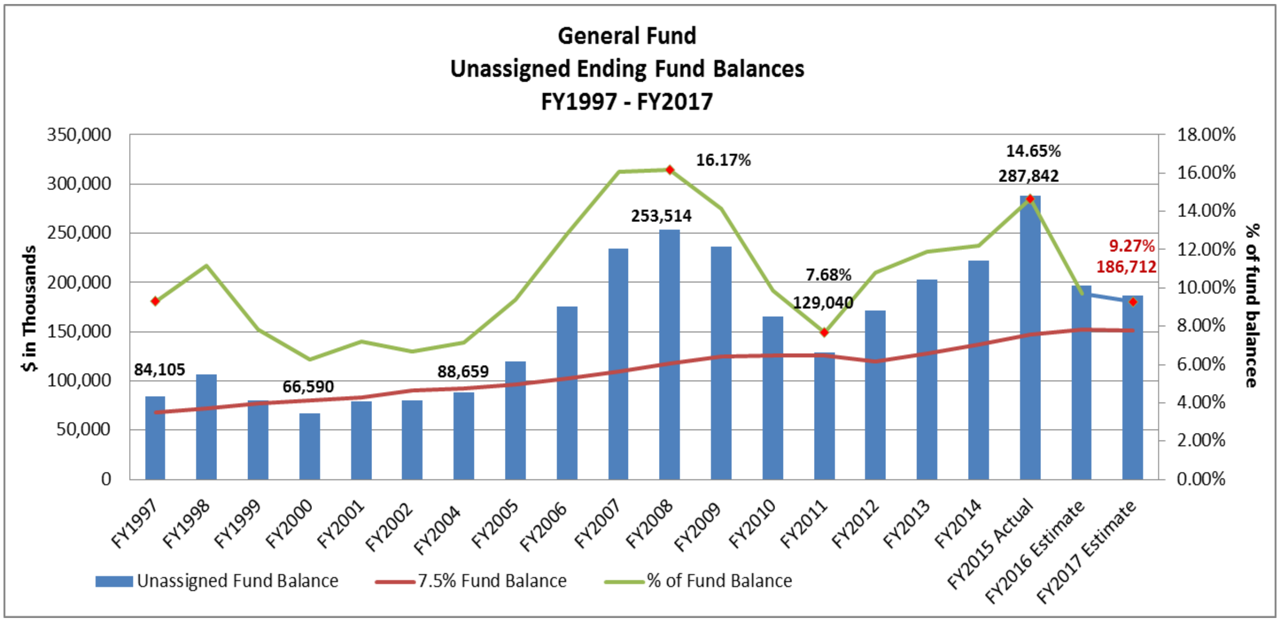
Department	**FY2017 Reduction**	**% of FY2016 Current Budget ***
Administration and Regulatory Affairs	$ 311	1%
Finance Department	855	4%
Fire Department	8,296	2%
General Services	419	1%
Houston Health Department	1,820	3%
Housing & Community Development	41	8%
Houston Emergency Center	587	6%
Human Resources	120	3%
Houston Information Technology Services	323	1%
Legal	311	2%
Library	636	2%
Mayor's Office	402	5%
Municipal Courts Department	763	3%
Department of Neighborhoods	196	2%
Parks and Recreation	142	0%
Planning & Development	192	3%
Police Department	5,800	1%
Public Works & Engineering	47	0%
Solid Waste Management	2,293	3%
General Government	2,236	1%
Total FY2017 Reduction Initiatives	**$ 25,789**	**1%**

* Rounded to the nearest percentage of FY2016 Current Budget for departments stated above.

As indicated earlier, savings achieved through staffing reductions are focused on non-critical positions that will not directly impact the essential services the City delivers; further, the administration will work to achieve such savings via attrition and elimination of vacant positions wherever possible. Specifically protected from staffing reductions are our classified police and fire personnel, and there are no layoffs in parks or libraries included in this budget.

Note also that this budget maintains the City’s commitment to ReBuild Houston, the pay-as-you-go infrastructure funding approach endorsed by Houston voters in 2010. This budget holds the General Fund’s contribution to ReBuild Houston proportionally consistent with reductions to the property tax rate as required by the revenue cap with no impact to the implementation of capital projects. It also includes a reduction to the City’s solid waste sponsorship program that subsidizes homeowner associations that choose to obtain solid waste collection services beyond those provided by the City.

Exhibit 9 – Unassigned Ending Fund Balances



As indicated in Exhibit 9 above, the City has traditionally held its General Fund balance at or above 7.5% of General Fund expenditures (the City's new financial policies call for 7.5% of General Fund expenditures excluding debt service and pay-as-you-go capital transfers). In FY2017, the unassigned ending fund balance is at 9.27% of expenditures less debt/PAYGO. It is the City's goal to maintain fund balance at or above 9%, well above the minimum required. Maintaining this larger cushion provides additional protection in the event of emergencies or further deterioration in economic conditions and helps maintain our credit rating and flexibility heading into FY2018.

Both recurring and non-recurring initiatives are included to balance the FY2017 Budget; these include limited layoffs and elimination of positions as indicated elsewhere in this document.

Without considering non-recurring items in achieving budget balance, the City would need to reduce an additional $93.9 million of expenses (Exhibit 10). This would require layoffs – both civilian and classified employees. The average annual pay for a municipal employee is approximately $76,000 with benefits; fire classified is approximately $91,000 with benefits and police classified is approximately $97,000 with benefits. For context, reducing $93.9 million in expenditures via staff reductions would require elimination of about 1,235 average municipal employee (non-classified) positions.

Exhibit 10 – FY2017 Significant Impact of Removing Non-Recurring Items

ALL FIGURES ARE PRELIMINARY AND SUBJECT TO CHANGE

($ in thousands)		
Additional Revenues		
TIRZ - Municipal Service Fees Revenue	$ 19,564	Recurring
Total Additional Revenues	**19,564**	
Expenditures Reductions		
Council District Service Fund	8,250	Recurring
Department Expenditure Reduction	25,789	Recurring
Service Chargeback Reduction to General Fund	2,200	Recurring
Other than Debt/PAYGO Reduction Subtotal	**36,239**	
Total Expenditures Reduction	**36,239**	
Additional Expenditure Reduction	**93,860**	
Fund Balance Drawdown	**10,000**	
Total Gap Closed	**$ 159,663**	

While the City's financial policies call for structural balance (recurring revenues greater than or equal to recurring expenditures), and the City could make staffing cuts to do so, non-recurring measures are included in this budget. With the work the City will do to achieve structural balance in FY2018-2019, it makes little sense to make staffing reductions of this magnitude to balance the budget while fund balance and other measures are available. This budget implements $55.8 million in recurring changes and preserves vital City services.

Additionally, the administration will continue to identify and implement further recurring savings. There are extensive opportunities to continue consolidating back-office operations, cutting unnecessary spending, streamlining operations, and eliminate unnecessary positions. Further, the administration will look closely at our reporting structures for efficiencies and begin renegotiations of our largest contracts where we have not already done so. As these opportunities are capitalized upon, the administration will remove one-time sources of funds and replace them with the savings generated. This targeted, strategic approach is preferable to across-the-board cuts now, before the administration has had sufficient time to fully evaluate operations and implement the changes needed to capture recurring savings.

FY2017 Preliminary General Fund Summary

Fund Name: General Fund
Fund No. : 1000

ALL FIGURES ARE PRELIMINARY AND SUBJECT TO CHANGE

	FY2015 Actual	FY2016 Current Budget	FY2016 Estimate	FY2017 Estimate
Beginning Fund Balance - Unassigned $	222,620,490	287,841,725	287,841,725	**196,393,647**
Revenue and Other Sources				
General Property Taxes	1,074,435,185	1,114,028,980	1,092,731,468	**1,133,190,875**
Industrial Assessment	16,735,785	18,200,000	18,992,572	**18,042,943**
Sales Taxes	667,061,076	688,837,000	636,300,000	**615,000,000**
Other Tax	15,992,280	16,678,981	16,615,981	**16,908,772**
Electric Franchise	100,564,568	101,141,850	101,145,516	**102,029,934**
Telephone Franchise	43,450,849	40,865,000	43,219,885	**42,000,000**
Gas Franchise	14,538,332	14,839,561	14,839,561	**15,015,585**
Other Franchise	31,282,727	30,945,026	33,155,801	**33,738,694**
Licenses and Permits	37,999,329	37,870,062	39,555,871	**40,019,911**
Intergovernmental	24,184,766	26,470,476	53,485,088	**70,151,379**
Charges for Services	63,272,442	53,207,496	58,678,460	**58,829,529**
Direct Interfund Services	47,851,393	50,705,238	53,552,058	**53,764,807**
Indirect Interfund Services	25,327,922	26,750,414	26,790,414	**27,436,084**
Municipal Courts Fines and Forfeits	25,446,825	28,698,175	22,812,017	**22,812,017**
Other Fines and Forfeits	4,731,606	4,155,722	4,309,422	**4,306,281**
Interest	3,039,623	3,000,000	3,600,000	**3,000,000**
Miscellaneous/Other	17,216,717	12,756,750	26,426,799	**13,824,806**
Total Revenue and Other Sources	2,213,131,425	2,269,150,731	2,246,210,913	**2,270,071,617**
Other Resources				
Sale of Capital Assets	46,651,874	5,500,000	5,501,000	**14,500,000**
Transfers From Other Funds	31,363,014	30,724,961	30,041,561	**12,049,011**
Total Other Resources	78,014,888	36,224,961	35,542,561	**26,549,011**
Total Available Resources	2,513,766,803	2,593,217,417	2,569,595,199	**2,493,014,275**
Expenditures and Other Uses				
Public Safety				
Fire Department	494,140,178	507,890,583	507,767,336	**504,651,890**
Houston Emergency Center	12,517,759	10,495,106	10,495,106	**10,148,271**
Municipal Courts Department	26,862,735	29,146,536	28,514,278	**29,561,764**
Police Department	741,251,982	801,945,758	800,945,756	**811,296,432**
Public Safety	1,274,772,654	1,349,477,983	1,347,722,476	**1,355,658,357**
Development & Maintenance Services				
General Services	41,817,398	41,382,513	41,221,640	**41,223,483**
Planning & Development	7,707,990	6,118,289	6,118,289	**4,189,347**
Public Works & Engineering	32,260,022	31,629,307	31,458,088	**31,943,989**
Solid Waste Management	74,793,572	75,771,536	75,771,536	**79,163,385**
Development & Maintenance Services	156,578,982	154,901,645	154,569,553	**156,520,203**

FY2017 Preliminary General Fund Summary

Fund Name: General Fund
Fund No. : 1000

ALL FIGURES ARE PRELIMINARY AND SUBJECT TO CHANGE

	FY2015 Actual	FY2016 Current Budget	FY2016 Estimate	FY2017 Estimate
Human & Cultural Services				
Department of Neighborhoods	12,018,096	12,263,579	12,263,579	**11,704,705**
Housing & Community Development	668,929	577,465	497,634	**532,760**
Houston Health Department	59,549,369	61,441,105	60,639,244	**65,639,362**
Library	38,707,100	40,205,473	40,137,935	**40,916,822**
Parks and Recreation	68,621,171	71,296,782	71,296,782	**73,139,214**
Human & Cultural Services	179,564,665	185,784,404	184,835,174	**191,932,864**
Administrative Services				
Administration and Regulatory Affairs	28,890,580	29,495,672	29,495,672	**30,522,833**
City Controller	8,135,147	8,730,584	8,682,542	**8,886,974**
City Council (1)	10,592,134	19,378,940	19,378,940	**10,329,476**
City Secretary	805,096	879,419	800,061	**907,691**
Finance Department	18,358,497	20,254,083	19,782,928	**19,622,040**
Houston Information Technology Services	22,554,445	24,594,024	23,950,478	**23,362,802**
Human Resources	3,285,302	3,637,406	3,578,886	**3,053,604**
Legal	15,072,057	15,839,370	15,746,041	**16,046,138**
Mayor's Office	7,600,250	8,164,446	8,164,446	**7,695,641**
Office of Business Opportunity	2,743,152	2,947,094	2,913,179	**3,048,590**
Administrative Services	118,036,660	133,921,038	132,493,174	**123,475,791**
General Government				
General Government	235,459,236	218,809,422	207,128,644	**185,877,435**
Total Expenditures Other than Debt / PAYGO	1,964,412,197	2,042,894,491	2,026,749,021	**2,013,464,650**
Debt Service and PAYGO Capital				
Other Adjustments (2)	0	27,758,000	27,758,000	**(23,544,022)**
Captured Revenue Transfer to DDSRF	0	22,288,000	22,288,000	**34,741,000**
Trans to PIB Bonds Debt Service	264,500,000	295,954,000	295,954,000	**281,959,000**
Debt Service and PAYGO Capital Projects	264,500,000	346,000,000	346,000,000	**293,155,978**
Total Expenditures and Other Uses	2,228,912,197	2,388,894,491	2,372,749,021	**2,306,620,628**
Fund Balance - Unassigned	284,854,606	204,322,926	196,846,178	**186,393,647**
Total Budget	2,513,766,803	2,593,217,417	2,569,595,199	**2,493,014,275**
Changes to Unassigned Fund Balance	0	(452,531)	(452,531)	**317,885**
Prepaid Items and Imprest Cash	2,987,119	0	0	**0**
Ending Fund Balance - Unassigned	287,841,725	203,870,395	196,393,647	**186,711,532**
Amount Assigned for:				
Budget Stabilization Fund (3)	20,000,000	20,452,531	20,452,531	**20,134,646**
Ending Fund Balance - Unassigned	287,841,725	203,870,395	196,393,647	**186,711,532**
Total Ending Fund Balance $	307,841,725	224,322,926	216,846,178	**206,846,178**

(1) City Council budget includes funding for Council District Service Project Program.
(2) Adjustments in FY2016 includes transfer to special fund and FY2017 includes debt prepayment from Building Inspection Fund.
(3) An amount not less that the greater of (a) 1% of expenditures (excluding debt service and PAYGO payment) or (b) $20M.
The General Fund Summary in some cases may not agree w ith some of the departmental totals due to prior year restatements.

FY2017 General Fund Revenues

Property and sales taxes are the City's largest revenue sources. Over the past ten years, these sources averaged about 74% of total revenues.

Exhibit 11 – General Fund Revenues

Summary of Major Revenues - General Fund (FY2007 - FY2017)

	FY2007 Actual	FY2008 Actual	FY2009 Actual	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Actual	FY2015 Actual	FY2016 Estimates	FY2017 Estimates
Property Tax	748,792	830,889	890,088	892,865	859,413	866,141	910,034	976,240	1,074,435	1,092,731	1,133,191
Sales Tax	461,417	495,173	507,103	468,965	492,824	546,543	600,256	629,441	667,061	636,300	615,000
Franchise Fees	189,551	190,196	190,322	190,868	190,563	192,760	195,304	189,989	189,836	192,361	192,784
Other	327,822	295,702	297,401	294,631	297,251	251,899	284,862	285,790	359,814	360,361	355,646
Subtotal	**1,727,582**	**1,811,959**	**1,884,913**	**1,847,329**	**1,840,052**	**1,857,344**	**1,990,457**	**2,081,459**	**2,291,146**	**2,281,753**	**2,296,621**
Growth		**4.88%**	**4.03%**	**-1.99%**	**-0.39%**	**0.94%**	**7.17%**	**4.57%**	**10.07%**	**-0.41%**	**0.65%**

The revenue projection for FY2017 is approximately $14.9 million (0.65%) higher than FY2016 estimates as summarized below. These figures are based on conservative assumptions including oil prices reducing to $19.00/barrel by the end of the year and going down further to $18.79/barrel by the second quarter in 2017.

FY2017 General Fund Revenues - Net Change to FY16 Estimates ($ in thousands)		
FY2016 Estimates incl. Other Resources	$	2,281,753
FY2017 Proposed Budget inc. Other Resources		2,296,621
Incremental Increase/(Decrease)		**14,867**
		0.65%
Revenue Increases /(Decreases):		
Property Tax (1)		40,459
Intergovernmental (2)		16,666
Sale of Capital Assets (3)		8,999
Licenses & Permits		464
Direct Interfund Services		213
Miscellaneous (4)		(12,602)
Transfer from Other Funds (5)		(17,993)
Sales Tax (6)		(21,300)
Others		(40)
Net Change of Revenues	**$**	**14,867**

Note:
(1). Property Tax revenues based on limitation Prop 1 + H.
(2). Includes additional $19.6 million TIRZ Municipal Service Fees in FY17.
(3). Includes one-time land sales of $12.5 million.
(4). Significant decrease due to one-time large settlement received in FY16.
(5).Transfer from Houston First for arts funding will be reported in Houston Civic Events Special Fund.
(6). Sales Tax decrease of 3.35% from FY16 Estimates due to the economic conditions.

FY2017 General Fund Expenditures

The City's primary expense is personnel, with public safety representing the largest component of City spending.

Exhibit 12 – General Fund Expenditures

Summary of Major Expenditures - General Fund (FY2005 - FY2017)

	FY2007 Actual	FY2008 Actual	FY2009 Actual	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Actual	FY2015 Actual	FY2016 Estimates	FY2017 Estimates
Police	581,787	618,304	657,225	662,766	663,420	621,739	697,417	723,066	741,252	800,946	811,296
Fire	360,542	388,352	422,718	435,852	448,175	420,198	433,176	452,316	494,140	507,767	504,652
Other Depts	516,747	560,828	588,757	577,750	568,443	548,106	574,856	646,205	729,020	718,036	697,516
Debt Service/PAYGO	209,000	222,850	232,948	240,020	220,837	220,507	240,203	243,813	264,500	346,000	293,156
	1,668,076	**1,790,334**	**1,901,648**	**1,916,388**	**1,900,875**	**1,810,550**	**1,945,652**	**2,065,400**	**2,228,912**	**2,372,749**	**2,306,621**
Growth		7.33%	6.22%	0.78%	-0.81%	-4.75%	7.46%	6.15%	7.92%	6.45%	-2.79%

On average, about 57% of the City's General Fund budget is allocated for police and fire, with about 30% distributed among the remaining 22 other departments (many of which directly or indirectly support public safety activities) and 13% for debt service/pay-as-you-go transfers.

FY2017 General Fund Budget Expenditures - Net Change ($ in Thousands)		
FY2016 Current Budget	$	2,388,894
FY2017 Proposed Budget		2,306,621
Incremental Increase/(Decrease)		**(82,274)**
		-3.44%
Contractual or Mandated increases:		
Compensation (1):		
Municipal Pay		9,213
Classified Pay		17,849
Subtotal Compensation:		**27,062**
Maintenance Renewal & Replacement		**1,496**
Election		**(2,000)**
Recycling Cost		**4,140**
Pension (2)		**15,465**
HPOPS Supplemental (3)		**14,284**
Subtotal Contractual/Mandated		**60,447**
Transfers/Pass Through Increases (offset by corresponding revenues):		**(14,453)**
Subtotal - Contractual/mandated & Transfers		**45,994**
Debt Service Transfers (4)		(13,995)
Pay-as-you-go Transfers to DDSRF (4)		(15,305)
Debt Prepayment (5)		(23,544)
Budget Reduction		(27,989)
Prior Year HPOPS Deferral		(25,500)
Current Year HPOPS Deferral		(12,500)
Council Service District Project Program		(8,250)
Others		(1,185)
Subtotal - Non Contractual		**(128,268)**
Net Change of Expenditures	**$**	**(82,274)**

Note:
1. Compensation pay based on meet & confer agreements with unions.
2. Pension contribution mandated by State Law, not contract.
3. Supplemental pension contribution for Police based on meet & confer as funded ratio is below 80%.
4. Decrease in Debt Service Transfers and DDSRF pay-as-you-go transfer as a result of debt refinancing.
5. Includes $23.5 million debt prepayment from Building Inspection Fund.

Next Steps – FY2018 at a Glance

Our work on the FY2017 budget is strategic and future-focused, planned with the understanding that today's decisions will impact our city's financial standing not just now, but in the years ahead. While FY2018 is likely to be another challenging budget year for the City, the administration's FY2017 proposed budget anticipates those future challenges and takes important steps to address them.

With the property tax revenue cap still in place, and the Houston economy likely to see limited growth the year ahead, FY2018 is likely to be another challenging budget year for the City. Our preliminary forecast range for FY2018 revenue growth is between 0% and 3.5%. Meanwhile, expenditures are expected to grow by as much as 8% in FY2018. Expenditure growth will be driven primarily by contractual and mandated increases, including pay raises for municipal and police classified employees covered by meet and confer agreements. We also anticipate that fire classified employees may receive contractual pay raises (firefighters have not received pay increases since March 2014), although our ability to achieve this will be heavily predicated upon reaching resolution on pension challenges.

With all this in mind, our focus is on implementing sustainable budget changes that do not just address FY2017, but prepare a path toward long-term structural balance, in which recurring revenues match or exceed recurring spending. The FY2017 budget includes $55.8 million in recurring expenditure savings and new revenue – these changes are lasting, and stand as evidence of our commitment to correcting our financial course through shared sacrifice and an understanding that every dollar saved today puts us in better stead for the years to come.

Our structural financial challenges in FY2017 are exacerbated by the property tax revenue cap, the economic slowdown, and rising debt and pension costs. We have taken a thoughtful, multi-pronged approach to solving these problems. In less than four months, we have reassessed and reduced City spending through steps including:

- Stringent limits on hiring for any positions other than critical front-line roles;
- A freeze on pay increases;
- Elimination of vacant positions;
- Targeted layoffs;
- Tighter management of contracts;
- Issuance of Executive Order 1-53, which calls for new policies and procedures to improve accountability and transparency as we budget and invest the public's money; and
- Working with our TIRZ boards to increase municipal service fees paid to the City to better match the service costs TIRZs generate.

We are proud of these accomplishments, all recorded in the administration's first 100 days. But our work is not done. The expenditure growth rates above do not include full funding of the City's unfunded obligations. If the City were to begin fully funding those obligations, expenditures would increase significantly. That is why we are moving so aggressively to address our long-term challenges with sustainable, long-term solutions, beginning with our pension challenges. We have already met several times with representatives from the pensions, and have initiated productive conversations about how to rein in our pension costs. Our pace will quicken once the FY2017 budget is put to rest.

In addition to addressing the pensions, we must also address the property tax revenue cap, which has been repeatedly cited by debt rating agencies as a significant threat to our fiscal health. We agree with the debt rating agencies that removing the property tax revenue cap will better position Houston to achieve long-term financial strength and stability.

We are also far from finished with our identification and implementation of additional recurring savings. There are extensive opportunities to consolidate back-office operations, cut unnecessary spending, streamline operations, and eliminate unnecessary positions. Further, we will look closely at our reporting structures for efficiencies and begin renegotiations of our largest contracts where we have not already done so. Capitalizing on these opportunities will allow elimination of one-time budget fixes; these will be replaced by the savings generated from our focus on efficient and effective use of public resources. This targeted, strategic approach is preferable to across-the-board cuts now, before the administration has had sufficient time to fully evaluate operations and implement the changes needed to capture recurring savings.

Thus far, the culmination of our work to date is a budget that prioritizes recurring improvements while protecting and, in some cases, improving vital City services. This budget does include some one-time gap-closing measures, but our charge is clear: we must wean the City away from fund balance drawdowns and other short-term, temporary solutions to our situation. Excluding our one-time solutions from the FY2017 budget would leave a deficit equivalent to the cost of more than 1,200 non-classified municipal employees. Were we to try and achieve budget balance solely through personnel reductions, the impact would be devastating to some City services and our community's quality of life. This is unacceptable. We must find other means of restoring the City's financial health. We are doing so, and with the assistance and support of Houstonians, we will succeed.