



OFFICE OF THE MAYOR
CITY OF HOUSTON
TEXAS

Lee P. Brown
Mayor

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

From: Lee P. Brown, Mayor

I am pleased to transmit to you the adopted budget for the fiscal year which begins July 1, 2003 and ends June 30, 2004 ("FY04"). This is the sixth and final budget of my Administration and has been, by far, the most difficult to balance without raising taxes or fees or compromising the core services provided by city government to our rapidly growing community. However, I believe this budget accomplishes this task.

Introduction and Overview

The Economic Downturn and Our Response - The fiscal year just ended (FY03) has seen a large and unexpected reduction in the revenues available from our second largest source of income, the sales tax. As the chart on page 4 demonstrates, sales tax has been a steadily increasing source of income to support city services for fourteen years, and the turnaround in revenue occurred suddenly after the FY03 budget had been adopted. Accordingly, we were forced to cut expenses and use one-time sources of revenue during the last fiscal year.

While we are not alone in experiencing this phenomenon, we have adjusted to the resulting decrease with minimum impact on services. We must also be prepared in FY04 for a greater level of uncertainty. The response to this uncertainty is that we must make more conservative revenue estimates to prepare for possible additional loss of revenue.

Reserves and the Need for a Drainage Fee - As part of our commitment to strengthen the city's financial position, I am pleased to report that we will begin the FY04 fiscal year with a larger reserve in the General Fund than we had at the beginning of FY03, this includes the increase to our Rainy Day Fund to \$20 million. The Any Lawful Purpose funding mechanism (e.g. the use of "excess" water and sewer revenue for drainage and other non-water uses) has now been effectively discontinued, leaving us without our historical source of drainage funding. In FY04, we are preparing for public hearings related to a drainage utility that will finally get us on the road to solving the problem of destructive flooding as we have experienced in recent years. I believe we will continue to experience these problems unless we commit additional resources to this problem.

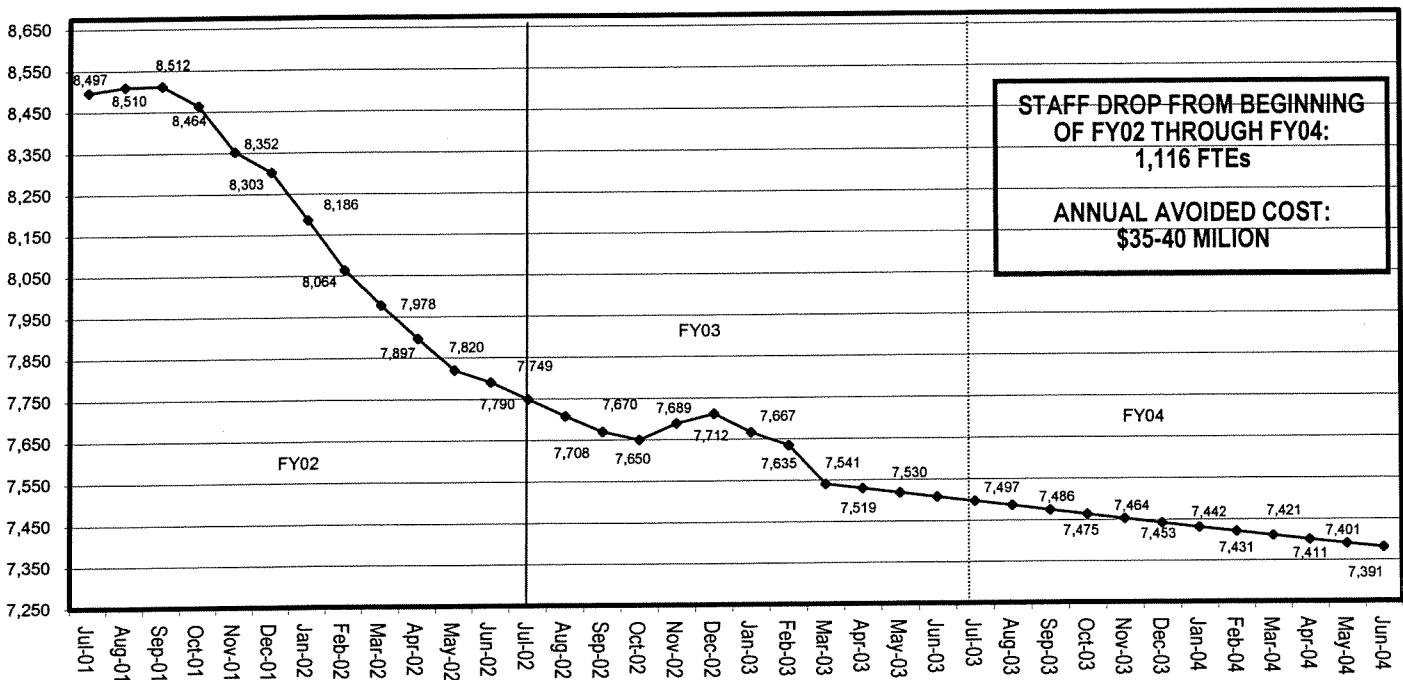
Six Years of Progress - The FY04 budget described herein maintains basic core services and addresses the key concerns expressed by members of City Council. It includes no increase in the property tax rate, and no increased water or sewer charges. Senior and disabled Houstonians will probably see their taxes go down as their exemptions are increased according to a five-year plan approved by City Council last year.

I will leave office with the property tax rate lower than it was when I became Mayor, tax exemptions higher, water and sewer rates the same, and having accomplished this while returning \$50 million to Metro in support of a project that I believe will make a large difference to Houston's future: light rail. In addition, I will leave office with our police officers on a solid path to adequate compensation and with each of our firefighting apparatus staffed at recommended levels. I am pleased we have been able to accomplish these important shared priorities.

Furthermore, we will have three sports stadiums that did not exist when I took office, a convention center hotel, several new entertainment venues downtown (including a world class convention center, a light rail line, completely repaved downtown streets, a new water treatment plan, a new airport terminal and runway, and many new parks, libraries, and community facilities). I am optimistic that we will add at least one Federally Qualified Health Center before I leave office, with a plan to add more in the coming years. Overall, I am pleased with this progress.

Civilian Staffing - Houston city government is becoming distinctly smaller and more focused with this budget, as we respond to the economic downturn and consumer confidence loss that began occurring last fiscal year. Our response was immediate after the tragedy of September 11th, 2001. We began limiting the hiring of staff to emergency, public safety and direct service staff only, with the result that civilian staffing had dropped by more than 1,000 since its peak in 2001. The graph below indicates the dramatic decrease in staff that has occurred. This trend to lower civilian staffing has continued in my FY04 budget, as will be discussed more fully in a later section of this letter.

GENERAL FUND CIVILIAN STAFFING TREND
 Prior and Current Fiscal Years: Filled Positions
 Future Fiscal Year: Fully Budgeted Staff (FTEs)



Public Safety Staffing - While we are reducing civilian staff, we are hiring firefighters to maintain the four-per-apparatus level that is generally accepted as the appropriate staffing level for engines and ladders. The FY04 budget includes seven new fire classes and three police academies! Public Safety continues to be our number one priority and this budget reflects that belief.

Street Program – The Downtown/Midtown street program is nearing 70% completion. In addition, many major arteries (e.g. Alabama, Westheimer, Clay, West 43rd, Pinemont, Kirkwood, San Felipe, Kirby, Austin and others) have been reconstructed or are under construction. Our neighborhood street overlay and maintenance program and pothole repair program continues to be of paramount importance, and this budget supports that priority need.

Hard Choices – In balancing this budget, hard decisions had to be made. In particular, the Capital Improvement Program is being extended by one year (unless additional funding becomes available as a result of the drainage utility) in order that we can make a smaller payment to our debt service fund, and I have already set in motion a reduction in staff positions which will involve involuntary separation of some employees. While I deeply regret the need for an involuntary Reduction in Force, our Human Resources Department has made maximum effort to find jobs for the displaced employees in our enterprise funds or in departments that have vacancies.

Financial Summary

This budget totals \$2.612 billion, including all of our enterprise funds and special revenue funds. The General Fund budget includes expenditures of \$1.407 billion. The budget is \$16.7 million (1.2%) above the expected FY03 spending, despite accommodating large increases mandated by higher employee health insurance costs (approximately \$17 million increase), Meet and Confer agreements (approximately \$21 million increase) with our police officers, and increased contributions to our pension funds (\$13.4 million).

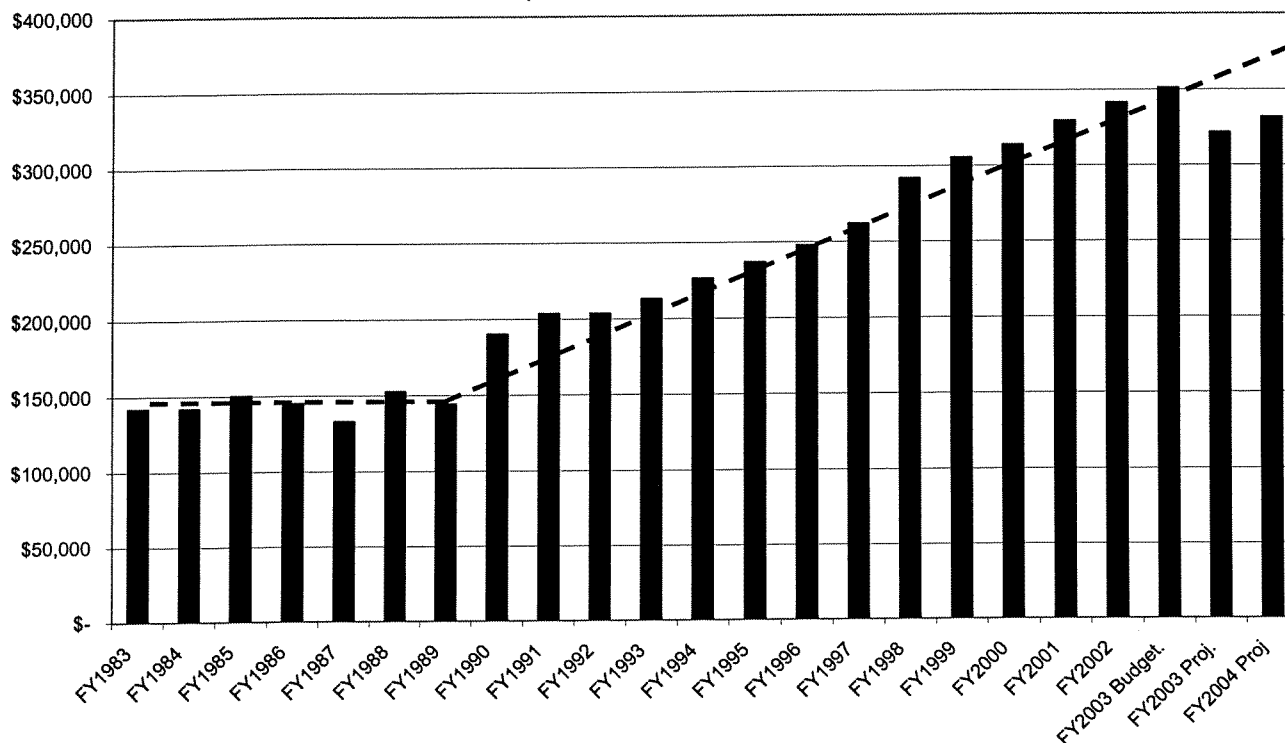
General Fund Revenues

Property Tax – The two largest General Fund revenue sources are the property tax and the sales tax, which together account for 71% of all revenues. We are anticipating a 3.6% increase in property tax revenues (much of which is due to new construction rather than revaluation), and are assuming that the tax rate will remain at 65.5 cents per hundred dollars of assessed valuation. The following table provides the comparable tax rates for the largest cities in Texas and demonstrates which of them has additional recurring revenue to support their General Fund activity.

City	Tax Rate	Garbage Fee	Drainage Fee	Electric System Transfer in Excess of Franchise fee
Dallas	69.98	Yes	Yes	No
San Antonio	57.854	Yes	Yes	Yes
Fort Worth	86.5	Yes	Yes	No
Austin	45.97	Yes	Yes	Yes
Houston	65.5	No	No	No

Sales Tax - The sales tax revenue used in this budget is the same amount as projected for the current year, despite Dr. Barton Smith’s economic model being somewhat more optimistic. We have added additional revenue for the 27 Limited Purpose Annexations that have been approved by City Council to become effective in FY04. Page II-9 and II-10 of this budget describes our estimation methodology in more detail. The following graph illustrates the growth in sales tax revenue over the last 15 years and the decrease in FY03 as well as our budget for FY04.

Annual Sales Tax Revenues
(amounts in thousands)



Collections - After a year of restructuring, I am pleased to say that both our Municipal Courts and ambulance collection areas are poised for revenue increases, although we have predicted only modest increases in revenue to remain conservative. During FY03, the privatized collection contracts for both areas were renegotiated, and new technology was approved for both: a court management computer system, and portable computer technology for EMS personnel designed to increase the quality of billable records. In addition, contracts have recently been approved related to address searches and a tie-in with the state database that denies drivers' licenses to individuals who owe the city money for a traffic fine.

We have also begun listing the names of seriously delinquent taxpayers in area newspapers and our collection firm has added staff in the area of business property delinquencies. Our City Council has also implemented strong procedures to deny city business to individuals and firms that are delinquent in their taxes.

Franchise Fees – FY04 will be the first full year of the franchise fee for solid waste haulers, a program that has been met with a high level of cooperation from the industry. Our electric and gas franchise fees are projected to increase modestly in FY04 as the economy returns to growth.

General Fund Expenditures

Overall, General Fund departmental expenditures are strictly constrained by our revenues and by our mandated expenditure increases. When the increases for HPD Meet and Confer, health insurance, and pension fund contributions are removed, our General Fund expenditures are less than what we expect to spend in FY03 by over \$34 million.

Streamlining Government – As noted earlier, we began reducing civilian staffing in FY02 as well as identifying opportunities for improved efficiencies and cost reductions. Among these are consolidated purchasing, elimination of discretionary travel and training and reduction of take-home vehicles and wireless devices. These efficiencies will continue into FY04.

In preparing their FY04 budget requests, departments evaluated their operations to identify the costs of core and non-core service for the purpose of identifying opportunities to reduce costs. While basic services will not be impacted, this resulted in several departments eliminating or reducing non-core services and in most cases a reduction in workforce.

Table I, which follows this letter, demonstrates the reduction of General Fund civilian staff by department over the last two fiscal years and compares staffing at the beginning of FY02 with the budgeted staff in FY04. Virtually, all departments are reducing their civilian staff, with the total civilian workforce expected to be 1,152 people (not positions) lower than the staffing as recently as the beginning of FY02. This is a 14% reduction in staff even though we are adding facilities and adding population!

Further, the budget includes opportunities for greater efficiencies and reduced costs by consolidating certain administrative functions within city departments located at 611 Walker and the elimination of unnecessary printing costs for city newsletters, reports, etc. by utilizing technology and Internet capabilities. Finally, during FY04 we will continue to hold spending on discretionary travel and training and will further reduce our light duty on-road fleet.

City Council initiated several budget amendments that requests the Administration to study major changes in governmental structure, with the goal of cost reduction through consolidation. I intend to begin this process during the remaining months of my administration to provide a head start to my successor in this important area.

General Government – This budget accounts for full funding for the Houston Emergency Center (see below), the contractual cost of living increase for our newly-privatized zoo, and an increase in expense for the 2003 general election and a possible runoff. Our General Government account also must be increased to absorb the cost escalation for health insurance for our retirees.

Houston Emergency Center – The Houston Emergency Center will be a state of the art consolidated center for our emergency dispatch function including fire and police dispatchers, 9-1-1 operators, and emergency management staff. I expect it to open in late summer and be an important public service to the citizens of Houston, especially in light of the events of September 11, 2001 and the increased need for homeland security. I believe the investment is important to all Houstonians.

Employee Benefits - The budget contains no compensation increases (other than contractual increases for our police officers) and no reserves for promotions and/or reclassifications. Health insurance benefits for all city employees and retirees remain funded at the aggregate 88% city, 12% employee formula, although both the city and employee contribution is increasing. The city's cost has increased approximately \$24 million in FY04, of which \$17 million is in the General Fund. One of the first duties of my successor will be to prepare for a new health insurance contract. I intend to have the process well underway prior to my successor assuming office.

Losses in the stock market have resulted in actuarial deficiencies in the city's three pension funds. Accordingly, this budget increases the contribution to all three systems according to actuarial valuations or negotiations with the pension boards. In the case of the firefighters, the individual firefighter's contribution is also increasing.

Police and Fire step pay is funded. Likewise, longevity pay for all employees is also funded at its required level. We were able to provide our Municipal employees a raise in FY03 and we continue to negotiate in good faith with the bargaining unit representing the firefighters.

Fund Balance

The ending fund balance is budgeted at \$104.7 million and is 8.4% of expenditures less debt service, well above the 5% requirement. The fund balance is budgeted to decrease by \$2 million from the beginning fund balance, yet this is an increase of almost \$5 million from the original FY03 budget. The decrease represents 1.9% of the beginning fund balance and could be restored if sales tax revenue rebounds. The fund balance includes the \$20 million designated as the "Rainy Day" cash reserve.

Enterprise Funds

The following paragraphs discuss the budget for the largest of various funds which do not share in tax money and which by and large act as independent enterprises with dedicated funding sources.

Aviation

The Aviation Department is facing a number of challenges in the upcoming fiscal year. Many airlines, from which the department collects a substantial portion of their revenue, are experiencing financial difficulty. Also, additional security measures mandated by the FAA are being put in place to make the airports a safer place.

The FY04 budget accomplishes the following objectives:

- Provide secure and safe airport facilities.
- Continued implementation of expansion programs at Bush Intercontinental and Hobby Airports.
- Continued efforts to expand passenger and cargo activity with particular emphasis on Pacific Rim and Latin American countries.
- Continuation of a job order contracting pilot program that can potentially be expanded throughout the entire city.

Water and Wastewater

The Water and Wastewater System is budgeting \$627.6 million for FY04, an increase of \$28 million from the current year. As mentioned previously, the FY04 budget includes no increase in water or sewer charges, and the Any Lawful Purpose Fund has effectively been discontinued by reducing the level of the Renewal and Replacement to a point below the threshold which makes "Any Lawful Purpose" funds available. No rate increase is necessary due to a planned debt defeasance in FY03 and the closing of the Any Lawful Purpose Fund. Our success in streamlining operations and strategically managing our finances has resulted in no rate increases during my tenure.

The Water and Wastewater Fund continues to implement competitive work practices, install technology, implement procedures to enhance customer service, preserve facilities, and meet environmental and regulatory standards. This budget accomplishes the following priority objectives:

- Maintain the "Superior" water system rating.
- Further reduce our use of ground water to achieve compliance with the Harris Galveston Coastal Subsidence District mandates.
- Expand the East Water Treatment Plant.
- Oversee the development of the Houston Area Water Corporation facility at Lake Houston.

Convention and Entertainment Facilities

The Convention and Entertainment Facilities (C&E) budget reflects the continuation of our policy to enhance the downtown area. Both the George R. Brown Convention Center (GRBCC) and the Hilton Americas Hotel construction remain on schedule and on budget.

However, the budget reflects the impact of diminished resources and is more conservative than in years past, as the hotel and motel occupancy tax, the largest source of C&E revenue, is expected to decline. Parking revenues are also expected to be lower, reflecting the general decline in travel and to some extent, a shift in parking habits that occurred when downtown garages were heavily damaged by Tropical Storm Allison.

The C&E budget of \$78.3 million reflects higher debt service payments as a result of the GRBCC expansion and the hotel. The fund balance has declined due to lower revenues (specifically hotel occupancy tax and facility rental revenue). However, it remains above the minimum requirements by 1.3%.

Conclusion

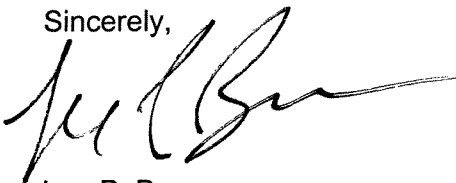
My plan for the FY04 fiscal year reflects the shared wisdom of our elected officials to concentrate on core services that can be afforded without raising taxes or fees to Houstonians. I believe this plan accomplishes these goals in a responsible manner.

I am indebted to the City Council who has sat through many presentations from department heads as we attempt to refine our vision of core services. Members of City Council have shared their vision with me and have provided constructive input through the many amendments that have been incorporated into this budget.

I wish to recognize the work of our City Controller whose office serves as an important financial control established by the City Charter. In an environment where corporate ethics appear to be constantly challenged, the City of Houston's financial reporting and accountability systems continue to get high marks from rating agencies and independent auditors.

And finally, I want to acknowledge the professionalism of our department heads and city staff members. The dedication and commitment to public service by all city employees is commended.

Sincerely,



Lee P. Brown
Mayor

TABLE I**GENERAL FUND CIVILIAN STAFFING**

Comparison of fully budgeted FY04 staff to actual paid staff at the beginning of FY02

<u>Department</u>	<u>Actual Paid Staff at Beginning of FY02</u>	<u>Fully Funded Positions in FY04 Budget</u>	<u>Difference</u>
Affirmative Action	32	27.7	-4.3
Building Services	316	287.7	-28.3
City Council	100	78.1	-21.9
City Secretary	14	15	1
Controller	86	81.1	-4.9
Finance and Admin	262	215.2	-46.8
F&A: 3-1-1	65	76.2	11.2
Fire	276	278.5	2.5
Health and Human Services	1,025	811.1	-213.9
Houston Emergency Center	260	190	-70
Human Resources	56	43.4	12.6
Information Technology	136	158.7	22.7
Legal	172	153.6	-18.4
Library	668	515.6	-152.4
Mayor	27	23.2	-3.8
Municipal Courts – Admin	423	365.5	-57.5
Municipal Courts – Justice	85	85	0
Parks	1,011	928.6	-82.4
Planning	232	204.9	-27.1
Police	1,596	1,379.5	-216.5
Public Works	1,053	961	-92
Solid Waste	602	501.8	-100.2
Total	8,497	7,381.4	-1,115.6

Note: The Houston Emergency Center (HEC) fund did not exist in July 01 although staff now budgeted in this fund was budgeted in Fire, Police and Finance and Administration at that time; for fair comparison, this staff (primarily call-takers and dispatch staff) has been shown in the first column as if the HEC fund had been in existence. The amount is larger than the current staff due to the economies of scale of the center.