City of Houston Testimony on H.B. 2

House Committee on Ways and Means
February 27, 2019

While many Texas cities are expressing concern about the potential impact of changes to the effective and rollback tax rates as proposed by House Bill 2, the City of Houston may be the only municipality able to speak from experience about the detrimental effect of a revenue cap. Based on direct experience and review of the City's revenue cap by ratings agencies, we strongly oppose any efforts to further limit elected officials' ability to generate needed income for the cities and communities they serve.

The City of Houston's revenue cap, added to the City Charter by voters in 2004, requires voter approval for increases in ad valorem taxes in future years above a limit equal to the lesser of the actual revenues in the preceding fiscal year, plus 4.5%, or a formula that is based upon the actual revenues received in fiscal year 2005 adjusted for the cumulative combined rates of inflation and the City's population growth. Voters also have increased available revenue sources in Proposition G (codified in Article IX, Sec. 21 of the City Charter) and Proposition H, which did not amend the City Charter.

As a result of these changes, Houston's 2018 tax rate is approximately 5 cents lower than the 2013 rate and its lowest since 1987. The City estimates that the revenue cap has resulted in more than $532.6 million in lost revenue since 2014, when the cap's impact was first felt. In the most recent year, the City estimates that property tax revenue was reduced by $152.7 million, enough to fund 1,152 police officers.

The Houston Police Department, despite its size as the largest department within the City of Houston, has approximately the same number of officers as it did in in the 1990s when it had 5,200 officers. Of note, the city of Chicago, which Houston will surpass to become the nation's third largest city, has 13,000 officers.

For the most recent year, the revenue cap yielded savings of approximately $115.09 for the average Houston homeowner, enough to buy a value meal at a fast food chain each month ($9.59).

Thus, the average Houstonian enjoys little benefit from the revenue cap, while the community pays the price by having 1,152 fewer police on the street.

Credit Rating Agency Warnings

When analyzing the impact of H.B. 2/S.B. 2 on other cities and counties throughout the state, the warning from credit rating agencies about Houston's situation should be carefully considered. The revenue cap has harmed the City of Houston's credit, an outcome suggested nearly a decade ago by Standard & Poor's ("S&P") in a report which asked whether property tax caps were an "unnecessary fix" and cited analysis that found "caps on tax rate hikes and appraisal increases … could cause more harm than good."

The more recent analysis has confirmed this perspective. When Moody's Investors Service downgraded the City's general obligation debt in March 2016, the revenue cap was one of four contributing factors along with decreases in oil prices, high fixed costs, and large unfunded pension liabilities.

The credit rating agencies all agreed regarding Houston's revenue cap:

- Concerns were raised by S&P in downgrading the City's rating, as S&P laid out the need for pension reform and encouraged lifting of the revenue cap: "Over the long term, we believe any modifications to existing charter-imposed revenue-raising limitations that reduces the amount of lost property tax revenue could provide additional credit strength."

- Moody's was more explicit, listing four factors that could lead to an upgrade: a stabilized economy with a return to strong growth, a sustainable plan for managing pension liabilities and achieving structural budget balance, increased financial reserves, and "removal of revenue cap, providing the city with flexibility to capture growth in assessed values." S&P concludes: "Over the long term, we believe any modifications to existing charter-imposed revenue-raising limitations that reduces the amount of lost property tax revenue could provide additional credit strength."

- Fitch Ratings noted that, "[t]he ability to increase ad valorem revenues is constrained by a 2004 voter approved charter amendment" while listing the "charter property tax limitation" along with pensions and weakness in the energy sector as tests for Houston's key rating drivers.

Disaster Impact

The City experienced a substantial natural disaster on August 23-27, 2017 resulting from Hurricane Harvey, when up to 50 inches of rain caused flooding in portions of the City. The estimate of the total damage to City facilities, properties, and infrastructure is projected to be approximately $2.48 billion. Any limitations on the ability to collect revenues to recover would only create a financial disaster in the wake of a natural disaster.

Proposition B & Pensions

Following the November 6, 2018 passage of Proposition B related to firefighter pay, Fitch Ratings put a negative outlook on the City's credit stating "if management is unable to absorb increasing expenditures and to adjust outlays to match ongoing revenues, negative rating action is likely."

Houston cannot control oil prices, but we are taking the appropriate steps to address the factors we can influence or control. We developed a long-range financial plan that charted a path to structural budget balance, where expenditures are equal to or less than revenues. The City has begun to implement the initiatives, and the rollout of the initiatives will be ongoing. The City worked closely with employee groups on pension reform, that was passed in the last legislative session that reduced the City's liability and limited long-term pension costs. Further limitations on revenues would only seek to undo the progress made with pension reforms and the ongoing initiatives that seek to move the City to a structurally-balanced budget.

Timeline Issues in Setting the Tax Rate

- First, under the bill, pursuant to Section 26.05(d-1) of the Tax Code, prior to holding a public hearing, the City must comply with Section 26.17 of the Tax Code. However, the City would not be able to comply with Section 26.17 because the maintenance and operations rate and debt rate are not available for publication in the proposed and adopted budgets. This is due to the fact that the proposed budget is typically released at the end of May prior to receipt of the certified roll. Meanwhile, the adopted budget is published by June 30th, again prior to receipt of the certified roll. Similarly, for the same reasons, the City would not be able to comply with Section 26.18 of the Tax Code (pertaining to posting certain information on the Internet website). Thus, the City would not be able to adopt a tax rate under Section 26.05(d-2) of the Tax Code.
- Further, under the bill, pursuant to Section 26.05(d-2) of the Tax Code, the tax rate may not be adopted until each appraisal district in which the City participates has delivered the notice required by Section 26.04(e-2) of the Tax Code. Notice must be provided by July 22, or as soon thereafter as practicable, to each property owner that the estimated amount of taxes to be imposed on the owner's property may be found in the real-time tax database described in Section 26.17 of the Tax Code. Thus, to adopt the tax rate, the City would need to be reliant upon the timeliness of other governmental entities.
- Lastly, pursuant to Section 26.05(a) of the Tax Code, if the tax rate exceeds the rollback rate, the City must adopt the tax rate before August 15. However, in 2018, the City did not even receive the last appraisal roll until August 21.

Conclusion

While we work to implement financial reforms recommended by the ratings agencies, further limitations on tax rates and the effective and rollback tax rates imposed on all Texas cities are precisely the kinds of policies that ratings agencies point to as a negative factor in Houston’s municipal finances. We respectfully ask that the Texas Legislature not impose the same detrimental practice on our sister communities across this state.