CITY OF HOUSTON — Interoffice Correspondence

Mayor's Office

To: City Council Members
Controller Ronald Green

Cc: Michelle Mitchell, Finance Director
Waynette Chan
Lloyd Waguespack

From: Mayor Annise Parker

Annise D. Parker

Date: March 5, 2010

Subject: **Budget Status**

There is no question that the choices we face this year will be difficult ones. Priorities, policies and strategies for budget balancing must not be simply buzzwords – they will need to guide our decisions for the most difficult budget challenges the City has faced since Fiscal Year 2004.

This memo will give an update on the budget process and review the next steps. Unfortunately, we do not have good news in this update. The gap is widening rather than narrowing.

FY2010

The current year budget is not yet finalized. We have not yet received the final certification of revenues for the General Fund from the Controller's office but should receive by the beginning of March. Finance's revenue estimate for sources of funds (including additional use of fund balance) is $29.3 million lower than the adopted budget. Due to this decrease, we have reduced departments' expenditures by $17.4 million.

As mentioned above the budget gap continues to widen even with the actions we have taken in FY2010. Currently the gap stands at $11.9 million.

We have immediate options available to address the gap.

1. Additional departmental cuts. Departments have delayed purchases, removed civilian vacancies and attrition, and stretched their budgets; a further cut will impact personnel.
2. Increase the drawdown of fund balance by the entire $11.9 million leaving an unrestricted fund balance of $163.1 million which is 9.7% of expenditures less debt service. (7.5% of expenditures less debt service would allow drawing down $49.3 million, leaving an unrestricted fund balance of $125.7 million).
3. Potentially transfer $7.0 million in Ike excess and drawdown $4.9 million leaving an unrestricted fund balance of $170.1 million (10.1% of expenditures less debt service).

FY2011 Budgets and Targets

The FY2011 budget currently shows a gap of $99.5 million.

The gap is due to a $43.1 million decrease in funds available and increased costs for:

- Mandated civilian and classified payroll of $30.8 million.
- Health benefits of $6.7 million (FY2011 Health Benefits plan not yet approved by Mayor).
- Pension obligations of $12.5 million (Fire classified pension calculated at 29.4%).
- Operating costs of new facilities $2.0 million.

- Electricity costs of $1.2 million.
- Fuel cost of $1.4 million.

The FY2011 assumptions also include the following:

- Reflects the impact of the FY2010 vacancy savings annualized in the amount of $4.6 million.
- $13.5 million transfer of excess funds from Ike Fund.
- $13.0 million in additional land sales.

Budget submissions from the departments are due on March 30, 2010.

Five-Year Forecast

An updated summary of the draft five-year forecast is also attached. This has been reconciled to the budget target update above. This continues to indicate that there are ongoing pressures in FY2011 and FY2012, with increased expenditures outstripping revenues.

Although the Rainy Day Fund is not included within the five-year forecast, as it is not part of the general fund operating budget, please note that $10-15 million will be reimbursed from the Ike Fund to the Rainy Day Fund by year-end FY2010. The balance of the $20 million loaned to the Ike Fund will be reimbursed no later than September 2010 (FY2011) per ordinance.

Next Steps

The next step in the process is as follows:

Next Step	Timing
❑ Provide additional guidance to the departments, including revised targets. Confirm that every department should submit additional reduction scenarios with their proposed budget. Provide guidance on what areas and expenditure categories should be reduced.	2nd week of March
❑ Finalize strategy for Police budget (including meet and confer meetings to begin).	March 9th
❑ Begin negotiations with the Fire Pension board with the goal of agreeing on accepting the actuarial number of 23.8% and agreeing to negotiate in good faith for FY2012 on actuarial assumptions.	3rd week of March (scheduled for the 19th)
❑ Consider additional revenue sources, debt service reduction to close gap.	Immediately
❑ Present the five-year forecast to the fiscal affairs committee	March 26th
❑ Present an outline of priorities for spending, policies established, and strategies for closing the gap to the fiscal affairs committee.	March 26th (if ready with strategy discussion)
❑ Finalize department budgets, including adjustments for health benefits, pension, electricity, etc.	Month of April
❑ Present proposed budget to Council and public.	May 12th

Alternative Strategies

A number of possible strategies exist for closing the FY2011 gap, some of which will be needed.

- Implement additional spending reductions based on the budget reduction scenarios to be submitted by the departments. An additional 1% cut would be $ 17.1 million, 2% would be $34.2 million, 3% would be $51.4 million, and 5% would be $85.5 million (further departmental cuts will impact personnel).
- Draw down the fund balance to the 7.5% preferred reserve.
- A furlough of civilian employees for two days per month equals $2 million in General Fund savings per month (e.g. $ 2 million x 12 months = $24 million). Classified furloughs could save approximately $2.3 million per day (e.g., $2.3 million x 12 days = $27.6 million).
- Possible consolidation of various departments.
- Negotiate with employee unions to defer pay increases to FY2012 or beyond saving $30.8 million in FY2011.
- Negotiate with the three pensions to reduce contributions to actuarial limits that will support current benefit levels.
- Apply more of the debt service reduction to General Fund relief, and/or further reduce debt service (approximately $13 million).
- Borrow $20 million from the Rainy Day Fund, which will deplete that fund.
- Additional sale of land scheduled for FY2012 moved to FY2011 (approximately $7.5 million).

If we do not address the budget situation by implementing some combination of these strategies, the only remaining option is raising taxes.