



**To:** City Council  
**From:** Clay Pearson, City Manager  
Amy Johnson, CFO  
**CC:** Senior Staff  
**Date:** September 15, 2022  
**Re:** Follow-up to Budget Presentation #4 (First Reading)

15 September 2022  
To: Mayor and City Council members  
Important background to address the open comments and questions from First Reading on 9/12. Please review and ask questions or comments early next week well prior to our meeting responsibilities with adopting the FY 23 Budget on 9/26.  
Clay

### Executive Summary

The first reading of the proposed budget occurred on 9/12/22 in the City Council Chambers. A recording of that meeting is available [here](#), and a copy of the presentations can be found [here](#), [here](#), and [here](#).

This memo contains responses to questions or requests for more information made by City Council during 1<sup>st</sup> reading of the FY23 Proposed Budget. Responses are organized by Fund and Department.

### **Question #1: What effect would reducing the General Fund’s fund balance to zero dollars above policy have on the property tax rate and government services?**

First, it is important to reiterate the City’s adopted [Financial Policies](#), which provide guidance on the use of fund balance.

Section V.A and V.C of the City Council-adopted financial policies outline the 90-day fund balance requirement and put restrictions on the use of Fund Balance.

Section V.A of the City’s Financial Policies states: *“The City shall maintain the General Fund unrestricted fund balance equivalent to 90 days of the total operating expenditures of the General Fund. If the fund balance exceeds this amount, **funding non-recurring expenditures or funding Pay-as-You-Go capital projects in the following fiscal year may be used** (emphasis added) to draw down the balance.*

Further, section V.C states: *“Fund balance/Working Capital shall only be used for **emergencies, non-recurring expenditures/expenses or major capital purchases that cannot be accommodated through current year savings. Should such use reduce balances below the level established as the objective for that fund, restoration recommendations will accompany the request/decision to utilize said balances.**”*

Section II.A and II.B outline the requirements for a balanced budget.

*Section II.A lists the requirements for the City Manager to propose: “The City shall annually adopt a balanced budget where annual revenues plus other means of financing such as fund balance are equal to, or exceed, operating expenditures. Any increase in expenses, decrease in revenues, or combination of the two that would result in a budget imbalance will require budget revision, rather than spending unappropriated*

*surpluses or designated reserves to support ongoing operations. All budget revisions will require the vote and approval of City Council before any additional spending of City funds. Any year end operating surpluses will revert to unappropriated balances for use in maintaining reserve levels set by policy and the balance will be available for capital projects and/or “non-recurring” expenditures.”*

*Section II.B details the current funding basis: “The City shall budget and operate on a current funding basis. **Recurring expenditures shall be budgeted and controlled so as not to exceed current revenues. Recurring expenses will be funded exclusively with recurring revenue sources to facilitate operations on a current funding basis.**”*

Per the City’s financial policies, the reduction of property tax revenue with the intent to use General Fund’s fund balance to make up for the lost revenue is not consistent with Policy unless those items are one-time expenses.

In other words, the budgeted positions for improving public safety, 4 firefighters, 2 telecommunications operators and 1 police officer should not be funded out of fund balance per the City’s adopted financial policies. However, Council always has the ultimate authority on the use of fund balance, any may choose to use fund balance to pay for these positions.

### General Fund Projected Fund Balance

The General Fund is forecast to be \$1,858,277 over the 90-day fund balance policy at the end of FY23. The estimated amount will change once revenues and expenditures are closed for FY22. If the fund balance dips below the 90-day policy the City’s Financial Management Policies requires a plan to replenish the fund balance. (Section II.L last paragraph).

	<b>FY 2021 Actual</b>	<b>FY 2022 Amended</b>	<b>FY 2023 Proposed</b>
Beginning Fund Balance	\$ 29,076,297	\$ 32,524,401	\$ 30,541,045
Revenue	94,083,921	105,001,128	109,315,462
Expenditure	90,570,329	106,984,484	110,711,878
Net	\$ 3,513,592	\$ (1,983,356)	\$ (1,396,416)
Ending Balance	\$ 32,589,889	\$ 30,541,045	\$ 29,144,629
Policy Minimum Balance (90 Days)	\$ 22,332,410	\$ 26,379,736	\$ 27,296,353
Amount Over/(Under) 90 Day Target	\$ 10,191,991	\$ 4,161,309	\$ 1,858,277
Days of Reserves	131	104	96

### Major One-Time Costs and Recurring Costs in the FY23 Budget

The FY23 Proposed Budget contains a mixture of General Fund items that are one-time costs and recurring costs.

The FY 23 budget approved on First Reading already contains \$1,518,779 in major one-time costs. Of this, \$1,396,416<sup>1</sup> in expenses are currently being paid with General Fund's fund balance.

### FY23 Major Items by Cost Type

Items	One-time Cost	Recurring Cost
1 Police Officer	\$72,000	\$113,865
Pay Raise +5.5% (6.5% for Police and Fire Uniformed Employees)	\$0	\$3.8M
2 telecommunications operators	\$0	\$337,081
4 Firefighters	\$0	\$436,520
Drainage Regular Maintenance Crew	\$0	\$662,000
Purchase of Police Equipment	\$200,000	\$0
Updating the Unified Development Code	\$300,000	\$0
Increase Sick buyback from 40 to 60 hours	\$211,779	\$0
Master Drainage Plan	\$435,000	\$0
Fire Radio Replacements Year 2 of 2 <sup>2</sup>	\$300,000	\$0
<b>Total</b>	<b>\$1,518,779</b>	<b>\$5,349,466</b>

### Reduction in Tax Revenue

Moreover, a reduction in the M&O property tax rate will reduce the amount of revenue from the TIRZ administrative charge which is “free” money to the General Fund operating from the TIRZ #2 that would otherwise go towards allowed projects. To reduce the number of days in reserve to 90 would require a \$1,858,277 reduction in General Fund revenue, split between Property Tax revenue and TIRZ Administrative Charge Revenue.

A reduction in revenues leading to the minimum fund balance policy of 90 days would involve a reduction of 0.011335 from the proposed rate. The proposed FY23 budget property tax alternative scenario will decrease the Maintenance and Operations (M&O) rate from 0.28500 to 0.273665 – reducing O&M Property Tax revenue from \$36,681,811<sup>3</sup> to \$35,222,904 – a \$1,458,907 reduction in property taxes and General Fund revenue. With this rate, the reduction in TIRZ Administrative Revenue would be \$400,070 – decreasing from \$13M to \$12.6M.

<sup>1</sup> See “Net” figure for “FY 2023 Proposed” Column General Fund Income Statement

<sup>2</sup> Year 1 of 2 funded via FY22 Budget Amendment #5

<sup>3</sup> Please note that this amount is the Property Taxes Current Taxes Account. The Budget Book shows property taxes inclusive of delinquent taxes, penalties and interests, and PILOTS, why the budget book property tax revenue on the General Fund Tab – Page 1 is larger than the \$36,681,811 in current taxes discussed here.

**Combining the TIRZ reduction and further Property Tax rate reductions creates a total revenue decrease of \$1,858,277 in the General Fund.**

The total rate would decrease from 0.623765 to 0.612430 by taking fund balance to offset expenditures. To date, there have not been off setting recurring costs identified, but there is a section later in this memo for a small change to make all of the recurring costs offset by use of General Fund’s fund balance.

As can be seen on the next page, the additional tax rate decrease would reduce homestead owners City property tax bills, on average, by an additional ~\$34. Paired with a proposed rate that already provides lower tax bills to residents, homestead owners bills would average ~\$91 less than what they paid in FY22.

**Changes on Sample Tax Bills -- Property Tax Rate of 0.623765 Scenario**

Example Property <sup>4</sup>	City of Pearland Property Tax Bill Change Compared to Prior Year Proposed Rate of 0.623765	City of Pearland Property Tax Bill Change Compared to Prior Year Alternative Rate of 0.612430	Difference from Proposed Rate to Alternate Rate
Zero Growth	-\$229	-\$263	-\$34
Homestead Example 1	-\$38	-\$70	-\$32
Homestead Example 2	-\$26	-\$49	-\$23
Homestead Example 3	-\$23	-\$45	-\$22
Homestead Example 4	-\$39	-\$71	-\$32
Homestead Example 5	-\$22	-\$43	-\$21
Homestead Example 6	-\$32	-\$58	-\$26
Homestead Example 8	-\$48	-\$88	-\$40
Homestead Example 9	-\$69	-\$125	-\$56
Homestead Example 10	-\$46	-\$84	-\$38
Homestead Example 11	-\$47	-\$85	-\$38
Homestead Example Mayor	-\$61	-\$112	-\$51
<b>Average</b>	<b>-\$57</b>	<b>-\$91</b>	<b>-\$34</b>

<sup>4</sup> Details on these example properties can be found at the end of this memo in Appendix A.

**Restatement of actual revenue differences and impact of State Worksheet “NNR”**

Potential Property Tax Rates and General Fund Revenue					
FY 23					
	FY22 Adopted Rate	"No New Revenue" Rate from State Worksheet	Alternate Rate to Extinguish Fund Balance over Policy	Proposed Rate	Voter Approval Rate Max (+3.5%) from State Worksheet
General Fund Rate(O&M)	0.309416	0.199279	0.273665	0.285000	0.289846
Debt Service Rate	0.392000	0.343765	0.338765	0.338765	0.343765
<b>Total Property Tax Rate</b>	<b>0.701416</b>	<b>0.543044</b>	<b>0.612430</b>	<b>0.623765</b>	<b>0.633611</b>
Revenue (Difference from FY22 Adopted)	\$30.1M	\$26.2M (\$3.9M less)	\$35.2M (\$5.1M more)	\$36.7M (\$6.6M more)	\$37.3M (7.2M more)
TIRZ Admin Revenue (Difference from FY22 Adopted)	\$12.7M	\$10.2M (\$2.5M less)	\$12.6M (\$100K less)	\$13.0M (\$300K more)	\$13.3M (\$600K more)
<b>Total Revenue</b>	<b>\$42.8M</b>	<b>\$35.8M</b>	<b>\$47.8M</b>	<b>\$49.7M</b>	<b>\$50.6M</b>
<b>Revenue Change from FY22</b>		\$7M less	\$5.0M more	\$6.9M more	\$7.8M more
Taxable Value to City	\$ 8,349,767,700	\$ 11,072,015,057	\$ 11,072,015,057	\$ 11,072,015,057	\$ 11,072,015,057
Property Tax Revenue as % of Taxable Value	0.36%	0.24%	0.32%	0.33%	0.34%

**Analysis of Using Fund Balance for Recurring Costs**

The positive aspect of further lowering the tax rate the full amount is that homestead owners would pay ~\$34 less in property taxes for the year. However, there are negative implications for the FY24 budget if Council chooses to override the City’s financial policies.

- First, credit rating agencies will notice that the City has elected to not follow its own financial policies. This could result in a negative change to the City’s credit rating, which would lead to higher interest rates and thus higher costs on capital projects.
- Second, being at the policy minimum somewhat increases risk by removing money that may be needed in the event of an emergency. If Council wishes to hedge itself against a potential economic recession, it may consider maintaining a fund balance above the 90-day policy minimum.
- Third, under SB2, there are tax rate implications for FY24. Reducing the O&M rate in FY23 will lower the No-New-Revenue (NNR) revenue available for O&M in FY24. As the City sells debt in FY23 the No New Revenue rate will require moving a portion of the total tax rate from O&M to Debt Service – meaning less money for O&M. This is the same issue the City is seeing with the No New Revenue Rate in FY23. Under the NNR there will likely be less O&M property tax revenue in FY24 – but the recurring costs paid for by fund balance in FY23 will remain. It is unclear if the City would be able to maintain the new staff being added in FY23 under the FY24 NNR rate. Paying for recurring costs out of fund balance would almost certainly mean less budget flexibility come FY24 – as those costs would become recognized as recurring costs (unless the positions are removed from the budget in FY24 after having been added in FY23).

- Fourth, **these are projections.** As we learned in FY22 revenues can come in higher or lower than expected. Thus, as the City reduces reserves to the policy minimum the fallout from a revenue shortfall would become more impactful due to a decreased reserve. **Of particular note is the Harris County uncertified tax rolls,** which will not be certified until after the budget and tax rate adoption. In general, last year Harris County *overestimated* the uncertified tax rolls for numerous cities who then found themselves with less property tax revenue once the rolls were finally certified after budgets and tax rates were adopted.

### **Alternative Proposal for small adjustment to acknowledge more one-time expenses**

The City's adopted financial management policies outline that General Fund's fund balance, per adopted policy, may only be used to pay for one-time expenses. Since the reduction in property tax revenue is a recurring revenue decrease (from the proposed rate) it would need to be accompanied with reduced recurring expenses, or the use of fund balance for more one-time items.

Fund balance could be used to offset **all** of the \$1,518,779 in one-time costs. This would increase the use of fund balance by moving (\$1,518,779-\$1,396,416) \$122,363 in expenditures from recurring sources (eg; property tax revenue) to one-time revenue sources (eg; use fund balance).

If the City Council wishes to follow the current financial policies, they could reduce the property tax rate and TIRZ #2 revenue by a total of \$122,363 – maximizing the use of fund balance to reduce property taxes while adhering to financial policies. For the \$122,363, the total property tax rate would be 0.623020. The O&M rate would be 0.284255 and the I&S rate would remain at 0.338765. This rate would reduce the GF property tax revenues by \$95,888 and TIRZ administrative charge revenues by \$26,475.

### **Conclusion**

Council is the ultimate authority on the use of fund balance and may choose to override the City's financial policies to pay for recurring costs with fund balance. As always, there are tradeoffs between following financial policies, minimizing tax burden, and providing services. The alternate proposal provides a middle ground for a further tax rate reduction while adhering to the adopted financial policies.

**Question #2: Did City staff account for the fact that some residents paid 10 base charges this past year when calculating the minimum necessary FY 23 water rates in the model?**

Base charges are established on a calendar year basis, and as shown below, there are 12 per cycle per year. It is important to once again state that any assertion otherwise about more or less base charges is not accurate.

2022			2022			2022			2022		
12/14/2022	12/28/2022	1/21/2023	11/19/2022	12/3/2022	12/27/2022	11/26/2022	12/11/2022	1/5/2023	12/3/2022	12/18/2022	1/12/2023
11/13/2022	11/27/2022	12/21/2022	10/19/2022	11/3/2022	11/27/2022	10/26/2022	11/10/2022	12/5/2022	11/2/2022	11/17/2022	12/12/2022
9/11/2022	9/30/2022	10/24/2022	9/18/2022	10/3/2022	10/27/2022	9/25/2022	10/10/2022	11/3/2022	10/2/2022	10/20/2022	11/14/2022
8/10/2022	8/31/2022	9/26/2022	8/17/2022	9/4/2022	9/28/2022	8/24/2022	9/11/2022	10/5/2022	8/31/2022	9/23/2022	10/17/2022
7/9/2022	8/1/2022	8/25/2022	7/16/2022	8/6/2022	8/30/2022	7/23/2022	8/13/2022	9/6/2022	7/30/2022	8/25/2022	9/19/2022
6/7/2022	7/2/2022	7/26/2022	6/14/2022	7/7/2022	8/1/2022	6/21/2022	7/14/2022	8/8/2022	6/28/2022	7/28/2022	8/22/2022
5/6/2022	6/2/2022	6/27/2022	5/13/2022	6/7/2022	7/1/2022	5/20/2022	6/14/2022	7/8/2022	5/27/2022	6/28/2022	7/22/2022
4/4/2022	5/3/2022	5/27/2022	4/11/2022	5/6/2022	6/1/2022	4/18/2022	5/15/2022	6/8/2022	4/25/2022	5/29/2022	6/22/2022
3/3/2022	4/3/2022	4/27/2022	3/10/2022	4/8/2022	5/2/2022	3/17/2022	4/15/2022	5/9/2022	3/24/2022	4/29/2022	5/23/2022
1/30/2022	3/4/2022	3/28/2022	2/6/2022	3/9/2022	4/4/2022	2/13/2022	3/16/2022	4/11/2022	2/20/2022	3/30/2022	4/25/2022
12/29/2021	2/2/2022	2/28/2022	1/5/2022	2/7/2022	3/3/2022	1/12/2022	2/14/2022	3/10/2022	1/19/2022	2/28/2022	3/24/2022
11/27/2021	1/3/2022	1/27/2022	12/4/2021	1/8/2022	2/1/2022	12/11/2021	1/15/2022	2/8/2022	12/18/2021	1/29/2022	2/22/2022
13	13*	13	12	12	12	12	12	12	12	12	12
*2nd Bill Date not assessed base charges, garbage and MUD			2 Due Dates in same month are 30 days apart.								

As covered with Council earlier this year, FY23 Rate is mainly driven by FY23 Bond Coverage Ratio. This ratio was written in the City [Bond Ordinance](#) and monitor by creditors such as TWDB. The ratio is driven by the following factors:

- $Bond\ Coverage\ Ratio = \frac{(Revenue - Operating\ Expenses)}{Current\ Debt\ Obligations}$
- FY23 Forecasted Revenue are driven by estimated future usage that based on the last 3 years of usage and system growth.
- Revenue and Expenses recorded in FY22 will not impact FY23 Bond Coverage Ratio.

Annual water revenues reported in the Annual Comprehensive Financial Report are not broken down into base charges and usage, it is strictly amounts billed during the 365-day fiscal year.

Lastly, the rate model is run through the budget process to try to best predict the revenues needed to run the business of the Enterprise Fund. The model and annual budgeting process should not to be conflated with the audit and accrual numbers of the past actual amounts used. Budget and Audit are based on different accounting standards and require significant financial expertise to compare. Despite multiple staff explanations about this, some continue to try and tie them to each other. While the outcome of the audit should track closely with the projected numbers of the budget, trying to tie the two together dollar for dollar is not an efficient use of staff

time, especially in the light of these same questions having been repeatedly answered over the past two years.

Please note as well that the rate model developed in-house by staff has been reviewed by Lechowicz & Tseng Municipal Consultants and determined to be sound and accurate for its assumptions and calculations. The final report should be available late next week.

**Question #3: What is budgeted in the Infrastructure Reinvestment Fund (Streets & Sidewalks)?**

The FY23 proposed budget contains \$1,593,714 for Street and Sidewalk maintenance. In FY22, additional money was added through budget amendments to increase this budget to \$2,406,453. While the FY23 proposed budget is below the FY22 Amended budget, it is a \$131,243 (9%) higher than the FY22 original adopted budget. The 9% growth represents fiscally sustainable growth not reliant on one-time influxes of General Fund cash into the fund.

On the other hand, per the City Engineer, an additional \$2.8M in annual funding is needed to maintain the Street and Sidewalk network at the current condition level. The total annual budget would need to be ~\$4.4M, a 176% percent increase, to be able maintain our street and sidewalk infrastructure quality. As infrastructure ages and is not maintained properly the cost of repairs will increase exponentially.

We should work to address this shortfall in the long-term, or else future ratepayers will bear substantially higher infrastructure costs (taxes) and worse quality street and sidewalk infrastructure.

	FY 2021 ACTUAL	FY 2022 ORIGINAL BUDGET	FY 2022 YEAR END AMENDED	FY 2023 PROPOSED BUDGET
<b>REVENUES</b>				
Investment Earnings	\$ 106	\$	\$ 250	\$
Transfers	1,609,752	1,462,471	2,406,203	1,593,714
<b>TOTAL REVENUES</b>	<b>1,609,858</b>	<b>1,462,471</b>	<b>2,406,453</b>	<b>1,593,714</b>
<b>EXPENDITURES</b>				
Streets	1,113,038	1,500,000	3,687,704	940,894
Sidewalks	36,549	53,000	1,294,403	652,820
<b>TOTAL EXPENDITURES</b>	<b>1,149,587</b>	<b>1,553,000</b>	<b>4,982,107</b>	<b>1,593,714</b>
REV OVER/(UNDER) EXP	460,271	(90,529)	(2,575,654)	
<b>BEGINNING FUND BALANCE</b>	<b>966,272</b>	<b>90,649</b>	<b>1,426,543</b>	<b>476</b>
Recognizing Prior Year Project Expenditures			1,149,587	
<b>ENDING FUND BALANCE</b>	<b>\$ 1,426,543</b>	<b>\$ 120</b>	<b>\$ 476</b>	<b>\$ 476</b>

The FY22 expenditures recognized the total programmatic funds made available since FY21. However, prior year expenditures should have been excluded. There is a line titled "Recognizing



Prior Year Expenditures” recognizing this so that funds will not be double spent. Fund balance is expected to finish on September 30,2022 at \$476.

**Question #4: What is budgeted in the Debt Service Fund?**

The Tax-Backed Debt Service Fund has \$47.9M in revenue budgeted. This is an increase of \$5,656,013 over the FY22 Amended Budget. The FY22 amended budget for this fund was purposefully adopted to spend down \$1.8M in fund balance to reduce the tax rate in FY22. The fund in FY23 does not have extra fund balance to perform the same tax rate maneuver in FY23. Indeed, FY23’s revenue must adjust for last year’s one time reduction in revenue while also covering increased debt service costs.

Tax-Backed Debt Service Fund Expenditures in FY 23 are budgeted to be \$46.6M – an increase of \$2,503,886. Of this, ~\$500K in additional money is budgeted for MUD rebates, which are *estimated* to cost ~\$7.75M this year. Bond Payments are increasing by ~\$2M over the FY22 amended budget. Bond payments are used to pay back debt-funded CIP projects, with the exception of Enterprise Water and Sewer projects, which are funded out of the Enterprise System.

The Debt Service Fund has been amended to reflect a somewhat smaller property tax levy for FY 23 than originally proposed and maintains \$732K over minimum fund balance given uncertainties with MUD payments and the Harris County certified valuation.

	<b>FY 2021 ACTUAL</b>	<b>FY 2022 ORIGINAL BUDGET</b>	<b>FY 2022 YEAR END AMENDED</b>	<b>FY 2023 PROPOSED BUDGET</b>
<b>REVENUES</b>				
Property Taxes	\$ 38,374,500	\$ 39,350,712	\$ 38,476,392	\$ 43,951,802
Miscellaneous	763,893	747,205	750,449	702,979
Transfers	2,530,075	3,074,369	3,074,369	3,302,442
Bond Proceeds (Refunding)	32,622,641			
<b>TOTAL REVENUES</b>	<b>74,291,110</b>	<b>43,172,286</b>	<b>42,301,210</b>	<b>47,957,223</b>
<b>EXPENDITURES</b>				
MUD Rebates	7,116,217	7,591,760	7,289,085	7,763,930
Bond Payment	67,450,250	36,834,004	36,834,004	38,863,045
<b>TOTAL EXPENDITURES</b>	<b>74,566,467</b>	<b>44,425,764</b>	<b>44,123,089</b>	<b>46,626,975</b>
REV OVER/(UNDER) EXP	(275,357)	(1,253,478)	(1,821,879)	1,330,248
<b>BEGINNING FUND BALANCE</b>	<b>6,162,589</b>	<b>6,200,953</b>	<b>5,887,231</b>	<b>4,065,352</b>
<b>ENDING FUND BALANCE</b>	<b>\$ 5,887,231</b>	<b>\$ 4,947,475</b>	<b>\$ 4,065,352</b>	<b>\$ 5,395,599</b>
Reserve 10% Over Policy	\$ 7,456,647 \$ (1,569,416)	\$ 4,442,576 \$ 504,899	\$ 4,412,309 \$ (346,957)	\$ 4,662,698 \$ 732,902

More information is available on the [City’s FY23 Budget Development Website](#).