



4 August 2023

Honorable Mayor Cole and City Council Members:

Among the duties of the City Manager is to prepare and submit the annual budget to the City Council. In accordance with Article 4, Section 4.10(c) (2) of the City Charter, I respectfully submit the FY24 Budget for the City of Pearland. The development of this budget is the result of countless hours of input from our departments and work from our budget staff to best meet the needs of the residents and accomplish the Council's Strategic Priorities. This balanced budget will continue to deliver efficient, quality services to the Pearland community within the capacity of our financial resources.

The overall General Fund operating budget for FY24 is \$114,257,282. The Water & Sewer Enterprise has an operating budget of \$72,407,037. The FY24 CIP is budgeted for \$371.0 million in planned expenses, while funding is allocated over the total construction time of the projects and estimated to be \$224.0 million in FY24.

Background and Context



Setting the framework for our FY24 budget is the tax valuation error that occurred when setting the FY23 tax rate. The discovery of the \$1.3 billion valuation error in November 2022 led to immediate actions to overcome a resultant \$4.7 million General Fund deficit and a \$5.6 million Debt Fund deficit. Through a budget amendment that included deferral of motor pool lease fee expenditures, deferral of the UDC update, use of ARPA funds, use of over-policy fund balance, restructuring debt, and defeasance of debt, we were able to move forward with the remainder of the FY23 budget intact.





With the error artificially driving our tax rate down almost 8 cents (\$0.077651) in FY23, the City did provide an actual tax cut to all homesteaded properties. However, as predicted, there are residual repercussions for the proposed FY24 budget which are similarly impactful. A key point demonstrating the impact is the FY23 Year End Amended Budget shows an operating deficit of \$7.06 million, which the FY24 budget must first address. The result is the FY24 Budget only includes a 1.5% increase in total expenditures. The proposed balanced FY24 Budget is set to mitigate these holdover FY23 impacts, while still meeting the service needs of our residents and business owners.

Realigning for Resilience



Moving forward, we are focused on our Strategic Priorities and their associated milestones, fundamental services, and our greatest asset (our proud personnel) to realign our future within the context of our current situation to build this budget. This document describes the budgetary work plan to realign our revenues with expenditures following the tax valuation error and leverage existing resources for maximum efficiency to build future resiliency within our finances as well as our infrastructure.

Economic Factors

Continued high inflation and relatively high interest rates have multiple impacts on the general economy, our revenues, and our expenditures. We continue to see inflation impact the cost and availability of our supplies, equipment, construction, and personnel. Additionally, these factors impact general construction and the new housing market resulting in a reduction of permitting fees. This slowdown is being addressed by a reduction in our contracted plan review/inspection services and continued monitoring to reallocate personnel assets to greater needs if activity remains slow for an extended period.





What Makes Us a Great Service Organization – People

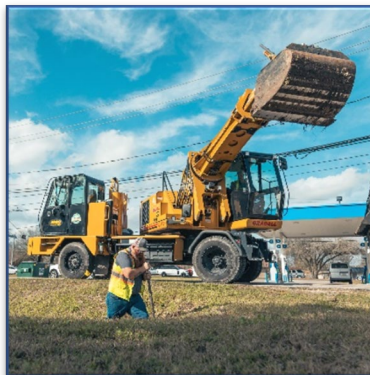
As a people organization, 67% of our budget is dedicated to our highly skilled and dedicated workforce. A top priority is taking care of our workforce because they face the same economic

challenges the City faces as a whole. Over the past two years, we implemented an extensive classification and compensation program that moved our pay plan to 100% of the market pay as recommended in the study. To remain competitive in the labor market that continues to be impacted by inflation, we must continue to invest in our people. The consequences of not keeping up with the

market are higher turnover, unengaged employees, and eventually a dramatic and substantial budget impact when we conduct a future compensation study. The proposed budget includes both the step plan and a market adjustment of 2%, which translates into a 5.0% increase for our Police Officers and Firefighters and 4.0% increase for all employees in good standing. Also included is the continuation of the Sick Buyback program at 60 hours and a 2% lump sum payment for employees who have topped out of their pay range.

Meeting Our Strategic Priorities

At our February 2023 Council Strategic Retreat, the Council affirmed our Strategic Priorities and developed the framework for milestones linked to each priority. Staff has developed the milestones into an actionable and measurable plan that will be presented back to Council for adoption and has driven the priorities for the FY23 budget. The major pieces incorporated into the FY24 budget include:



- **A concerted, intentional focus on improving customer service** across all departments and platforms. FY23 included a migration to an updated Cisco call center application that will facilitate moving to a 311 Call Center in the future. The next step included in the FY24 budget is to develop a business plan for implementation.
- **Drive future growth through redevelopment and reinvestment in older areas of the community.** Via resolution, the PEDC budget will now include a specific goal of





dedicating 20% of the budget to recapitalize infrastructure in the older parts of town. Additionally, an Old Town Master Plan is funded by the PEDC. The study will include an analysis of the housing, infrastructure, public spaces, parks, streetscape, neighborhood amenities, and commercial development within the Old Town area to create an achievable and realistic redevelopment plan.

- **Increase the Drainage Fund by adding the additional \$125,000** as originally called for in the Council Resolution. The funds will address our need for a stormwater inspector to meet the state requirements of our Municipal Separate Storm Sewer System (MS4) permit and provide additional contracting capacity for ditch cleaning and street sweeping.
- **Significant gains on our large Fire apparatus replacement** by adding two (2) pumpers and one (1) ladder truck.
- **Evaluating and developing a long-term plan to consolidate our Fire and Police dispatching** to positively impact internal efficiencies and response times.
- **Addition of two (2) Police Officer positions** plus two (2) patrol vehicles to address rising response times.
- **Improving emergency preparedness** by including an on-site All-Hazards Type 3 Incident Management Team course.

Other Budget Highlights

In addition to the items highlighted under the Meeting Our Strategic Priorities section, we have included the following priorities:

- **Enhanced Certification Pay for the Police Department** – Our Cert pay for the PD had fallen behind most other jurisdictions. To remain competitive for new hires, we moved the certification pay to the average of our peer cities.
- **Police Department Radio Replacement** – PD's radios are at the end of their lifecycle and must be replaced before January 2024 to avoid any service interruptions.
- **Adding Personnel by reducing Part-Time Budgets** – Finding and retaining part-time personnel for both the Fire Department and Parks & Recreation have proved to be challenges impacting both overtime and our ability to provide coverage. We can better serve Pearland in both areas with full time employees. The costs of the additional personnel plus equipment, vehicles and supplies are offset 100% by reducing the appropriate part-time employee budgets.
- **Completing Phase II of the generator heater enclosures** – This will complete the work recommended by the Generator Assessment study conducted after Winter Storm Uri to build resilience in emergencies.
- **Replacement of approximately half of the network switches** nearing end of life and recommended for replacement per the IT 5-Year Strategic Plan.





- **Addition of new restrooms at Centennial Park to support the newest softball fields** – We now qualify by hosting a minimum of ten (10) qualifying tournaments to spend Hotel Occupancy Taxes on event facilities. The new restrooms are necessary for the east fields and will eliminate having to bring in temporary restroom provisions during tournaments while also meeting a need for everyday use.

Property Tax Base and Rate

We once again have extraordinary growth in our property tax base that will fund the FY24 budget. The 2023 Total Taxable Value (not including TIRZ 2), which funds the FY24 budget, is \$10.85 billion up from \$9.45 billion in tax year 2022; a 14.8% growth rate. In addition, the taxable value of TIRZ 2 rose from \$3.38 billion to \$3.91 billion; a 15.7% increase.

The value increase is juxtaposed against the enormous artificial drop in the tax rate of almost 8 cents last year driven by the tax valuation error. Since January 2023, when the initial analysis of the error was completed, we have recognized that an increase in the rate for FY24 was inevitable without serious repercussions to our personnel, service levels, and public safety.

The state Tax Rate Calculation Worksheet dictates the parameters by which we establish our tax rate. The worksheet has been run by City staff in parallel with our consultant Assessments of the Southwest (ASW). In addition, we have been in contact with both the Harris Central Appraisal District and the Brazoria County Tax Assessor-Collector to ask questions, verify numbers, and vet our calculations. We are confident that this multi-pronged approach has resulted in an accurate and verifiable worksheet, in addition to following the recommended best practices of our tax rate error audit. The results are a 2023 No New Revenue tax rate of \$0.551675 and a Voter Approval Tax Rate of \$0.714766.

To support the proposed budget, which includes minimal additional personnel, minimal increases to address inflation, a modest compensation increase for our personnel, plus a few high-priority supplemental requests, we are recommending an Operations and Maintenance (O&M) tax rate \$0.3225 and a required Debt Service rate of \$0.3329 for a total tax rate of \$0.6554: an increase of \$0.031635 over last year but \$0.046016 below the FY22 tax rate of \$0.701416.

After the state-mandated adjustments per the Tax Rate Calculation Worksheet, our value will generate \$41.09 million to cover our Debt Service principal and interest payments and \$40.05 million to support our General Fund O&M. The TIRZ administrative fee will result in an additional \$15.68 million to the General Fund for a total general fund tax revenue of \$55.73 million. Additionally, the TIRZ will continue to reimburse our Debt Fund for all the TIRZ reimbursable projects over the next six year until its expiration slated for 2029.

Sales Tax Revenue

Sales tax revenue for the upcoming FY24 is budgeted at \$32.0 million, up 3.5% from the FY23 year-end amended amount. That increase is an amount that will be monitored closely through the year for adjustment as necessary due to inflation and any other potential economic impacts.





Other Revenues

Total Licenses & Permits revenue is budgeted at \$4.0 million, slightly above the FY23 amended budget. Permit revenue was down during FY23 but is expected to partially recover in FY24 based on projects in the pipeline. The impacts of interest rates on development projects will be closely monitored during the year for correction as necessary. Franchise Fees, Fines and Forfeitures and other miscellaneous revenues are expected to remain approximately the same as FY23.

General Fund Expenditure Overview & Fund Balance

General Fund expenditures are \$114.3 million. On a functional basis, 60% of expenditures are in Police and Fire, up even more as a share from prior years.

Fund Balance was reduced to the policy minimum of 90 days with the FY23 budget amendments. Our stated goal was to return the amount to approximately \$500,000 above policy. The Ending Fund Balance in the proposed FY24 budget is approximately \$430,000 above our 90-day minimum.

Budget Challenges and Unresolved Issues

While we have addressed many of our highest priorities, there are many needs and items identified in our Strategic Priorities that are not addressed within this budget. These include:

- **Fire fleet gaps** – With FY23 and FY24 budgets we will have 6 heavy apparatus on order; however, by the time they begin arriving over the next 1-4 years, we will need to have 4 additional replacements and the truck for Fire Station 7 on order. Also, we need to order 2 ambulances every other year to keep that part of the fleet up-to-date and operational. We will continue to explore creative methods to address this need until all apparatus are fully accounted for in the motor pool.
- **Police personnel** – We have recognized the need to increase staffing resources for the Patrol Division, improving citizen interaction, and reducing response times. While the addition of two police officers supports this objective, the need is much larger for both patrol and dispatch.
- **Fire personnel** – Our past hiring ratio practice of 1.1:1 leaves us dependent upon marginally available part-time personnel and expensive overtime. We intend to continue adding to get to a 1.2:1 ratio, which will then be evaluated to determine if that optimizes the balance between available personnel and a reasonable amount of overtime.
- **Certification pay for Emergency Management** – There is need for a more robust certification pay system in our total compensation approach, particularly in the area of emergency management. Certification pay rewards staff for pursuing critical training which provides the City with a competitive advantage, boosts efficiency, and grows knowledge and skills while establishing credibility. It is an additional form of compensation without impacting base salaries.





- **IT Internal Service Fund** – While we have established the IT internal service fund, we have yet to begin setting aside money to address the capital replacement costs. The IT Strategic Plan identified \$26.0 million of expenditures necessary over the next 5 years to replace equipment and programs that are vital to our daily delivery of services. This budget only addresses a limited number of those items, with significant program replacements for the Police Department Records Management System and our Enterprise Resource Planning looming in the next few years. Future budgets will need to include funds to address these large expenses.
- **Facilities Internal Service Fund** – While we have established the Facilities internal service fund, we have yet to begin setting aside money to address the capital replacement costs. The Facilities Assessment study identified \$9.4 million of unfunded expenditures necessary over the next 5 years to replace equipment and building systems that are vital to housing our personnel and serving the public. Future budgets will need to set aside funds to address these large expenses.
- **Motor Pool** – This budget only replaces a minor portion of our aging fleet that is not yet covered by lease fees. Additionally, the availability of fleet vehicles in the market has substantially impacted our ability to even order many vehicles for FY23.
- **Fire Station #7** – The 2023 Bond Program includes the construction of Fire Station #7 with a scheduled opening for FY27. For previous expansions of our fire service, we have hired in advance. To meet that need, we await the results of an application for a SAFER grant that will offset some of the cost of new personnel for up to 3 years. Additionally, with the well documented 3-to-4-year lead time for fire apparatus, we need to order the equipment soon. We are evaluating Motor Pool resources and will make a recommendation on how to move forward prior to the FY24 mid-year budget amendment or for FY25.
- **Homestead Exemptions** – City Council has expressed an interest in increasing our current 2.5% homestead exemption. A discussion on the item in June 2023 examined the financial implications of a larger exemption and the impacts on homesteaded residents and non-homestead properties alike, especially considering pending state legislation at the time. There was no consensus on direction forward and we intend to bring back this item for further discussion this fall.
- **Additional Staffing** – Most departments have personnel needs to meet expected or required service levels that are beyond the means of this budget. Staffing papers and staffing studies will be used as the basis for personnel requests in future budgets.





Enterprise Fund (Water and Wastewater) Overview



With the creation of a standalone Utility Department, we have a new opportunity to launch our Pearland Water branding and establish a renewed focus on maintaining and operating in a financially sound and efficient manner. In the initial evaluation of separating the Utility Department from Engineering & Public Works, we have identified some personnel gaps that are addressed by the FY24 budget. We are adding three personnel to oversee environmental health & safety and regulatory compliance, business administration of the budgets, contracts, and inventory, and a management assistant to oversee the administrative services division. While extremely important to the operations of the department, the new positions have little impact on the overall budget in comparison to the major cost drivers in the rate model.

The water and wastewater industry across the state and nation are recognizing the lack of adequate, sustained investment in recapitalization and resiliency in the most vital daily products and services we provide. The lack of past investment has resulted in many providers announcing significant multi-year rate increases. We are experiencing the same with the capital improvement program for the City's water and wastewater system driving the cost to provide these life sustaining services. The necessary rate increases to support these investments, have been well documented and communicated. Those rate increases support daily operations dealing with significant inflation affecting the prices of required chemicals averaging around 40%, the debt to build the 10 million gallon per day Surface Water Treatment Plant, which will begin providing water this fall, and the debt to rebuild approximately 50% of our wastewater capacity at the Barry Rose and JHEC plants. While projected rate increases are less than prior multi-year projections, we have a continued need to increase revenue to meet requirements for literally hundreds of millions of dollars in investments. The result will be a durable and resilient system that meets demand.

In the FY23 budget, our rate model projected the need for a 16% increase in revenue in FY24 and a 19% increase in FY25. With significant water sales during the current drought and the current project schedules, those have moved in a positive direction with a proposed increase in FY24 of 14% and a projected FY25 increase of 17%. Starting in FY27, when the major capital investments are completed, we see the increases moderating substantially.





Revenue requirements are such that an increase in rates for a sample 6,000-gallon usage customer will be about an additional \$12.40 per month, or 14%. The rate structure moves so that the base customer with only the first-tier base of 2,000 gallons pays \$6.40/month more.

Conclusion

I first want to thank our department Directors and their budget teams for understanding the current financial situation and submitting tight operational budgets with less than a 3% increase while dealing with much higher inflation costs. Additionally, many departments did not pursue all their personnel and supplemental needs knowing we would likely be able to support only the highest of priorities with this year's budget. Our City continues to grow and, in many areas, we are still playing catch-up from the high growth years to have the resources, personnel, and capacity to deliver the services expected by our community. We will continue to work towards meeting and exceeding these expectations in the future.

I thank the Mayor and City Council for their dedicated work to providing direction through our strategic priorities and milestones. Those foundational aspirations guide our budget priorities, departmental goals, divisional goals, and individual goals giving us organizational clarity as to where we want to be as a City.

A special thanks to our budget development team – Rachel Wynslow, Chan Tran, Peter Williams, Laurie Turner, Steven Wonsey, Amy Buckert, Kendra Murphy, Ron Fraser, Joel Hardy, and Megan Flowers; plus, Joshua Lee and many more in providing critical administrative support and specific area expertise such as CIP.

Every budget is difficult and the result of dedication and hard work by our team; however, this year has proved to be the most difficult I have ever experienced. It has been necessary to learn and comprehend the intimate details of the tax rate worksheet and the voluminous backup documentation necessary to understand and get accurate numbers into the state worksheet. Additionally, for most of our budget team, we are learning on the fly as this is not only their first Pearland budget but their first municipal budget. So, from an artificially low tax rate in FY23 to needs that far outstrip resources, we have made difficult but well-thought-out choices to **realign** our finances for future **resiliency**. In conclusion, while the FY24 budget does not fully complete our recovery from the tax valuation error of FY23, the FY24 budget does fundamentally overcome the budget shortfalls that we addressed with temporary measures in FY23 setting us up for the future. As we move forward, we will continue investing in our people, infrastructure, and financial resilience to make Pearland THE Community of Choice.

Respectfully submitted,

Trent Epperson
City Manager

