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May 17, 2017

Good afternoon. My name is David Eichenthal. I am a Managing Director with the PFM Group and I help to lead our Management and Budget Consulting practice. I am the lead partner on our work with the City of Houston on the development of a Ten Year Financial Plan. Thank you for the opportunity to provide this update to the Council.

Since our kickoff meetings in mid-October, the PFM team has completed our work on the development of a ten year budget model for the General Fund and DDSRF. We have completed a preliminary analysis of projected revenues and expenditures for the ten year period. We have completed our research on tax competitiveness and economic conditions. And we have largely completed our best practices and benchmarking analysis and started to develop a final list of potential initiatives designed to achieve savings or increased revenue during the course of the Ten Year Plan.

Let me now turn to some of our findings and provide some examples of the initiatives that we are exploring based on our research and analysis to date.

Developing a Baseline Ten Year Forecast

One of the first steps toward developing a ten year projection of revenues is to understand the trajectory of the local economy. Population and job trends directly affect property and sales tax projections – the two principal sources of revenue for the City.

In looking forward, it is helpful to understand recent history.

The Houston metro region economy has experienced long-term sustained job growth and relatively rapid recovery from economic downturns. Between 2010 and 2014, Houston regional employment growth typically exceeded national growth rates by between one and three percentage points. Historically, the energy sector has driven economic growth in the City. But over the last thirty years, Houston's economy has become increasingly diverse. Between 2000 and 2014, job growth in the region was driven by the health care and leisure sectors. And since 2010, population in the Houston MSA grew faster than any other major metropolitan area.

While the metro region has experienced consistent job and population growth, Houston's share of that growth has declined and future growth in the region is increasingly projected to occur outside of the city. Between 1970 and 2015, City population grew by 86 percent – as the City's size grew through a 40 percent increase due to annexation. Between 2000 and 2014, absent new annexation, the City's share of regional population declined from 41.8 percent to 34.5 percent.

Based on projections from HGAC, Houston's population is expected to grow by just under 650,000 residents by 2040 and, as a result of faster regional growth, the City's share of regional population will drop to 29.7 percent. The decline in regional population share has coincided with a decline in regional jobs share – dropping from 65.9 percent in 2002 to 60.4 percent in 2014.

Thus, while projections suggest that Houston will continue to grow, it will likely capture a smaller share of population and job growth. This will have a direct impact on City revenue.

As a result of the City's revenue structure, any slowing of the City's population growth will affect future revenue growth. Houston is more dependent on property tax (47.0 percent of General Fund revenue) than Texas peer cities -- such as Austin, Dallas and San Antonio (41.4 percent) -- and other large cities (18.4 percent) – such as Chicago, New York, Los Angeles and Philadelphia. Between FY 2011 and FY 2016, property and sales tax growth accounted for more than 80 percent of net revenue growth for the City.

Historically, City and regional population change accounted for 94.3 percent of the change in taxable valuation: in other words, just looking at population change helped to predict more than ninety percent of all change in property tax value.

These population and economic trends help to define the revenue side of the forecast, but what about the cost of City government?

Houston's structural deficit is defined by expenditure growth exceeding revenue growth over time. Between FY 2011 and FY 2016, expenditure growth was driven by significant increases in pension contributions, health insurance, debt service and related costs. These three categories accounted for 68.4 percent of the increase in spending between FY 2011 and FY 2016. General Fund pension contributions alone increased by more than $105 million -- from $195.7 million in FY 2011 to $300.8 million in FY 2016. Total cost of salaries increased just 4.0 percent over the six-year period. This reflects both limited wage growth and significant reductions in General Fund full-time employees, particularly in non-public safety departments.

On a year-by-year basis, the City took a series of steps to achieve balanced budgets. As the Great Recession set in, by FY 2011, the City had developed a $57.1 million structural deficit from a sluggish economy and expenditure growth. The City implemented a series of belt-tightening measures including reductions of most departmental budgets by 4 percent to 27 percent, consolidations of fleet, IT, HR, and payroll, and a series of employee layoffs. Expenditures were cut 4.6 percent. These efforts resulted in a $50 million surplus by FY 2012.

By FY 2013, the City was able to suspend service cuts and layoffs, flat-funding most departments, and boosting its General Fund reserves by about $45 million. Although by FY

2013, expenditure growth began to exceed revenue growth, the significant savings achieved in FY 2012 were sufficient to keep the City's budget in balance. By FY 2014, the City was able to restore service cuts, reducing the annual surplus to approximately $18 million. By the following fiscal year, the City's economy had largely recovered, with property and sales taxes rising 8.5 percent.

However, by FY 2016, a decline in energy prices produced a $26 million drop in sales tax revenues, which together with large increases in pension contributions, produced a $39.5 million deficit. That year, expenditure growth began to outpace revenue growth by 4.5 percent, generating a new structural deficit. In 2015 and 2016, the City was also not able to fully recognize increases in property taxes as a result of the revenue cap.

Using these historic trends as a starting point, the PFM team worked with City Finance to develop a long term forecast for expenditures and revenues. It is worth noting that it is not the purpose of a forecast – especially a ten year forecast – to precisely predict the future. It is not a crystal ball. Instead, the goal of a forecast is to provide a set of projections based on reasonable and clear assumptions.

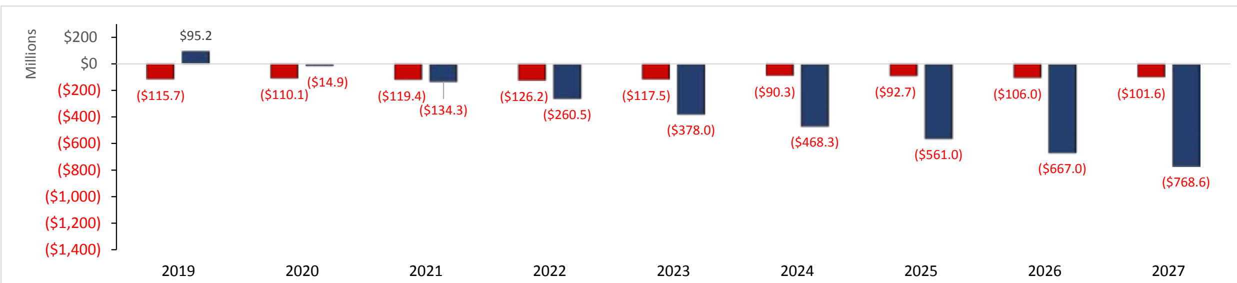
Different assumptions will yield different forecasts. The PFM forecast makes a number of assumptions, some at variance from assumptions that the City has used in developing its own five year forecasts. As a result, in its presentation to the Council last week, the City presented a range of projected budget gaps for the FY 2018 – FY 2022 period.

The following are some of our key assumptions for the FY 2019 – FY 2027 period:

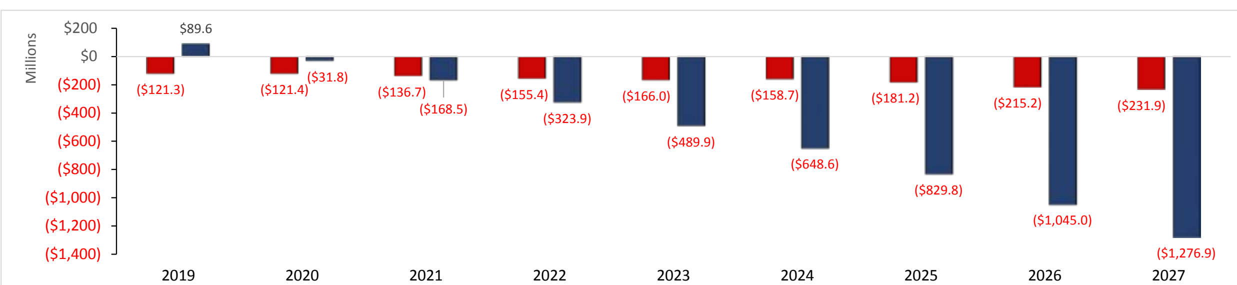
- PFM forecasts that baseline property tax revenues will grow modestly from 2.2% to 4.0% per year. This forecast is based on projected City and metropolitan area population growth, capped by combined growth in CPI and population under the revenue cap.
- Revenue from the City's sales tax is assumed to grow modestly from 2.4% to 3.2% per year. This forecast is based on historical trends and projected growth in employment, inflation, and oil prices.
- All personnel cost forecasts assume no net change in the size of the City's workforce over the full ten-year period. However, employee turnover from attrition and new Police and Fire cadet classes are assumed in the projections, but assuming no net change in overall staffing. The projected growth in personnel costs is the result of assumed increases in per employee benefits and cash compensation for current staffing levels.
- PFM assumes full implementation of the City's pension reform plan, including issuance of pension obligation bonds.

- Full-time salaries, part-time salaries and other elements of paid compensation, such as overtime, termination pay, and shift differential, are assumed to grow at levels assumed in the current Meet and Confer Agreements and remain flat thereafter.
- Based on historical trends in health care cost growth nationally, the baseline forecast assumes that the cost of active health benefits will grow by 7.7% annually.

Based on these assumptions, we project that the City will run a cumulative deficit of $979.5 million from FY 2019 to FY 2027 – without an increase in headcount or out-year increase in wages – over the projected period.



By just adding CPI based out-year wage increases, the cumulative gap grows to $1.4 billion from FY 2019 to FY 2027. Again, this is the structural deficit with pension reform fully implemented.



The City has projected that without pension reform, but with the City paying the full cost of its annual required contribution and with an assumed rate of return of seven percent, the additional cost to the General Fund between FY 2019 and FY 2027, would top $2 billion. Thus, without pension reform and with just CPI based wage increases, the cumulative deficit would grow to more than $3.45 billion.

Impact of the Revenue Cap on the Structural Deficit and Overall Tax Competitiveness

In developing our baseline forecast, we did not assume any change in the current cap on property tax revenue. Yet, the revenue cap is a significant factor in the City's structural deficit – a factor that will multiply in its importance over the next ten years.

Between FY 2011 and FY 2016, property value in Houston increased by 43.8 percent: yet, because of the revenue cap, actual property tax revenue increased by just 27.8 percent. Between FY 2016 and FY 2017, property value increased by 7.7 percent: because of the revenue cap, growth in property tax revenue was limited to 3.7 percent.

Over the period of the Ten Year Plan, our preliminary review indicates that the combined effect of pension reform and eliminating the revenue cap would close the City's structural deficit and provide sufficient resources in the out years for CPI growth in wages.

The City would also be able to make significant progress in meeting its next major long term fiscal challenge – OPEB liability. Like many cities, Houston currently funds its retiree benefits – or Other Post-Employment Benefits (OPEB) – on a pay-as-you-go basis. In the long term, this is not a sustainable approach. As of the City's FY 2016 CAFR, the City had an unfunded OPEB liability of approximately $2 billion.

In considering the implications of the elimination of the revenue cap, it is also important to understand what the potential impact would be on the overall ability to attract and retain new residents and new businesses. As part of the development of the Ten Year Plan, the City asked that PFM assess Houston's tax competitiveness.

Rather than merely looking at tax rates, PFM examined actual tax burden – the actual amount that different households pay for government. PFM compared the major state and local tax burdens of Houstonians with those of residents living in peer cities elsewhere in the region, the state, and the nation. Comparison cities include the five largest incorporated suburbs with which Houston competes for residents (Katy, Sugar Land, Pasadena, Pearland, and Woodlands); the four other major cities in Texas (Austin, Dallas, El Paso, and San Antonio); and the five other cities in the U.S. with over 1.5 million residents (New York, Los Angeles, Chicago, Philadelphia, and Phoenix).

The three major taxes used in the comparison are the general sales and use tax, the real property tax on residential property, and individual income tax for those municipalities located outside of Texas. Because some communities administer public services through special taxing districts – such as metropolitan utilities districts (MUDs) or fire service districts -- instead of through the local municipality, the analysis takes into account all overlapping state and local taxing jurisdictions. Finally, in order to compare how each municipality distributes its tax burden among its residents, the aggregate tax burden was calculated based on a range of gross annual household income levels: $25,000; $50,000; $75,000; $100,000; and $150,000.

Among other things, our analysis found that Houstonians earning over $75,000 a year would pay more than twice as much in taxes should they relocate to New York or Philadelphia and over 50 percent more should they relocate to Los Angeles, Chicago or Phoenix.

We found that Houston's tax burden is also consistently lower across household incomes than peer Texas large cities (El Paso, Austin, San Antonio, Dallas) and neighboring suburbs (Pearland, Pasadena, Katy and Woodlands): only Sugar Land had a consistently lower tax burden.

Finally, we found that while Houston's current tax structure is very competitive for working, middle and upper income families, the tax burden for a household earning just $25,000 is within 3 percent of the median of national large cities and suburbs and within $200 a year of the projected tax burden for a household in New York City.

Estimated Overall Tax Burdens by Income Level (Including Property Tax, Sales Tax, and Income Tax)

Households Earning $25,000/year			Households Earning $50,000/year			Households Earning $75,000/year		
Rank	City	Est. Tax Burden	Rank	City	Est. Tax Burden	Rank	City	Est. Tax Burden
1	Philadelphia, PA	$4,790	1	Philadelphia, PA	$6,473	1	New York, NY	$9,458
2	Chicago, IL	$4,295	2	New York, NY	$5,851	2	Philadelphia, PA	$9,115
3	Los Angeles, CA	$4,006	3	Chicago, IL	$4,936	3	Chicago, IL	$7,199
4	Phoenix, AZ	$3,448	4	Phoenix, AZ	$4,819	4	Phoenix, AZ	$7,158
5	Dallas TX	$3,333	5	Los Angeles, CA	$4,635	5	Los Angeles, CA	$6,917
6	Austin TX	$3,247	6	El Paso TX	$4,045	6	El Paso TX	$6,020
7	New York, NY	$3,146	7	Austin TX	$4,000	7	Austin TX	$5,942
8	Houston, TX	$2,976	8	San Antonio TX	$3,735	8	San Antonio TX	$5,543
8	Katy, TX	$2,976	9	Pearland, TX	$3,577	9	Pearland, TX	$5,295
8	Sugar Land, TX	$2,976	10	Dallas TX	$3,569	10	Dallas TX	$5,279
8	Pasadena, TX	$2,976	11	Pasadena, TX	$3,373	11	Pasadena, TX	$4,982
8	Pearland, TX	$2,976	12	Katy, TX	$3,176	12	Katy, TX	$4,675
8	Woodlands, TX	$2,976	13	Houston, TX	$3,110	13	Woodlands, TX	$4,587
9	San Antonio TX	$2,913	14	Sugar Land, TX	$3,076	14	Houston, TX	$4,576
10	El Paso TX	$2,789	15	Woodlands, TX	$3,070	15	Sugar Land, TX	$4,536
Median (excl. Houston)		**$3,061**	**Median (excl. Houston)**		**$3,868**	**Median (excl. Houston)**		**$5,742**
Median vs. Houston		**2.9%**	**Median vs. Houston**		**24.4%**	**Median vs. Houston**		**25.5%**

Households Earning $100,000/year			Households Earning $150,000/year		
Rank	City	Est. Tax Burden	Rank	City	Est. Tax Burden
1	New York, NY	$13,398	1	New York, NY	$20,780
2	Philadelphia, PA	$12,694	2	Philadelphia, PA	$18,438
3	Los Angeles, CA	$9,697	3	Los Angeles, CA	$15,621
4	Phoenix, AZ	$9,379	4	Phoenix, AZ	$13,679
5	Chicago, IL	$9,357	5	Chicago, IL	$13,270
6	El Paso TX	$7,669	6	El Paso TX	$10,989
7	Austin TX	$7,557	7	Austin TX	$10,810
8	San Antonio TX	$7,025	8	San Antonio TX	$10,010
9	Pearland, TX	$6,686	9	Pearland, TX	$9,490
10	Dallas TX	$6,662	10	Dallas TX	$9,451
11	Pasadena, TX	$6,266	11	Pasadena, TX	$8,854
12	Katy, TX	$5,848	12	Katy, TX	$8,215
13	Woodlands, TX	$5,778	13	Woodlands, TX	$8,181
14	Houston, TX	$5,717	14	Houston, TX	$8,019
15	Sugar Land, TX	$5,670	15	Sugar Land, TX	$7,960
Median (excl. Houston)		**$7,291**	**Median (excl. Houston)**		**$10,410**
Median vs. Houston		**27.5%**	**Median vs. Houston**		**29.8%**

While PFM did not conduct a full analysis of factors that are leading middle and higher income residents to choose other places to live within the region, our review suggests that it is unlikely that tax burden is a major reason for Houston's declining share of region population.

Problem Solved?

The goal of local government is never just to achieve a balanced budget. Balanced budgets are essential, but alone do not guarantee economic competitiveness or quality of life.

While implementing pension reform and eliminating the revenue cap would eliminate the structural deficit and allow the City to make significant progress in addressing its OPEB liability, these important steps alone would not provide sufficient funding to meet the long list of deferred investments by the City.

For example, Plan Houston -- the City's General Plan -- details a series of strategies that would require additional capital and operating spending. In 2016, the City surveyed Houston residents on those components of the Plan that should be priorities. The ten areas that were rated highest were:

- Crime and Public Safety
- Flooding
- Potholes and Street Condition
- Traffic Congestion
- Transportation Options (Rail, Buses and Bike Lanes)
- Walkable Streets
- Affordable Housing
- Air Quality and the Environment
- Access to Job Training
- Supporting Schools and Afterschool Activities

These areas of focus also all came up in meetings with City department heads, members of the City Council and community stakeholders. Investments in these areas are needed to achieve both long term savings and social benefits and to allow for continued growth.

For example, investments in access to job training and supporting schools can have a beneficial long-term financial impact by increasing the number of residents working and paying taxes and reducing the demands on City services. Similarly, the best way to reduce crime and the cost of public safety is almost always through prevention – through increased policing and intervention. Affordable housing – particularly targeted to individuals who would otherwise be homeless – can also reduce demands on other City services, such as police and fire.

Transportation infrastructure is essential for the movement of goods and people, whether residents or commuters. Investments in the City's environmental infrastructure are essential for maintaining basic quality of life and the livability of neighborhoods.

Lifting the revenue cap might provide some additional funding for these investments, but certainly not enough to fully fund new investments across all of these focus areas.

At the same time, the City also has to meet basic needs related to its existing civic infrastructure. An analysis of more than 460 City buildings by the General Services Department identified more than $630 million in deferred maintenance. The absence of investment has also challenged the City's ability to adhere to a regular maintenance and replacement schedule for the City's fleet.

Greater Efficiency and Effectiveness is Needed to Fund Investment

To ensure that Houston has sufficient resources to move beyond fiscal sustainability and toward achieving goals for continued growth and economic competitiveness, the City needs to take steps beyond pension reform and elimination of the property tax revenue cap to increase efficiency and effectiveness.

Our analysis of best practices and benchmarking has largely focused on six broad areas:

- Public Safety
- 21st Century Workforce
- Operations
- Coordination and Collaboration
- Culture of Performance
- New Partnerships

We are currently in the process of developing initiatives in each of these areas. While we have not completed analysis of fiscal impacts, let me give you some examples of the recommendations that we are considering.

Right-Size Public Safety

While overall personnel costs drive the day-to-day costs of the City of Houston, most City employees and most City spending is focused on the public safety functions largely housed in the Houston police and fire departments. Approximately 60 percent of all non-Enterprise Fund employees are in Police and Fire. The focus on public safety in Houston is typical for many U.S. cities – especially those that do not also have County functions or responsibility for local schools.

Many factors drive the number of police officers and firefighters needed in a city. But population is certainly one measure of determining need.

Compared to other major cities, the Houston Police Department has one of the lowest rates of FTEs per capita. Based on 2015 FBI data, Houston has 289.1 police FTEs per 100,000 capita – higher than Austin and San Antonio, but trailing every other major U.S. city. Cities like New York, Chicago and Philadelphia have significantly more FTEs and sworn officers per capita. Houston has more violent crime per capita than the two benchmark cities with fewer FTEs and officers per capita. If Houston had the same number of police FTEs per capita as Los Angeles, it would have an additional 695 FTEs.

Benchmarked Police Departments *2015 FBI UCR Reported Officers & Civilians*					
City	Population	Sworn Officers	Total Department FTEs	Sworn Officers per 100,000	Department FTEs per 100,000
New York	8,550,861	35,395	50,366	413.9	589.0
Chicago	2,724,121	12,034	12,902	441.8	473.6
Philadelphia	1,567,810	6,413	7,229	409.0	461.1
Los Angeles	3,962,726	9,863	12,665	248.9	319.6
Dallas	1,301,977	3,484	4,040	267.6	310.3
Houston	2,275,221	5,178	6,577	227.6	289.1
Austin	938,728	1,750	2,290	186.4	243.9
San Antonio	1,463,586	2,191	2,708	149.7	185.0
Median Excl. Houston	**2,275,221**	**6,413**	**7,229**	**267.6**	**319.6**

On the other hand, the Houston Fire Department, based on data from benchmark city budgets, has one of the highest rates of FTEs per capita. At 18.9 FTEs per 10,000 residents, Houston is second, behind New York: Houston has more FTEs per capita than Chicago, Dallas, Philadelphia, Austin, San Antonio and Los Angeles. If Houston had the same number of fire FTEs per capita as Philadelphia, it would reduce headcount by nearly 600.

Benchmarked Fire Departments *FY 2016-17 Budgeted FTEs*			
City	Population	Department FTEs	FTEs per 10,000 in Population
New York	8,550,861	16,431	19.2
Houston	2,275,221	4,308	18.9
Chicago	2,724,121	4,849	17.8
Dallas	1,301,977	2,279	17.5
Philadelphia	1,567,810	2,573	16.4
Austin	938,728	1,316	14.0
San Antonio	1,463,586	1,797	12.3
Los Angeles	3,962,726	3,729	9.4
Median Excl. Houston	**1,567,810**	**2,573**	**16.4**

To right size staffing within public safety over the next decade, we are reviewing a number of potential recommendations for the Fire and Police Departments.

Our preliminary analysis suggests that the Fire Department can take a number of steps to reduce personnel without having a negative impact on public safety and without the need for layoffs. In 2015, the 4,120 firefighters in the Houston Fire Department responded to a total of 5,564 calls for fires – with just 1,627 responses to structural fires. In Houston, as a percentage of total fires, structure fires represented 29.2% of fire incidents – the second lowest percentage among benchmark cities – and, on a per capita basis, the number of structure fires in Houston was lower than all other benchmark cities except for Austin.

Benchmark Fire Departments
2015 Fire Department Data (NFIRS)

City	Population	Budgeted FTEs	Structure Fires	All Fires	Structure Fires as % of Total Fires	Structure Fires per 10,000 in Population	Structure Fires as % of Total Calls
New York	8,550,861	16,301	27,403	45,476	60.3%	32.0	4.7%
Houston	2,275,221	4,366	1,627	5,564	29.2%	7.2	0.8%
Dallas	1,301,977	2,279	1,080	2,777	54.1%	8.3	0.9%
Philadelphia	1,567,810	2,153	2,885	6,340	43.3%	18.4	2.7%
Austin	938,728	1,304	551	1,900	29.0%	5.9	0.6%
San Antonio	1,463,586	1,754	1,095	2,909	37.6%	7.5	0.7%
Median Excl. Houston	**1,463,586**	**2,153**	**1,095**	**2,909**	**54.1%**	**8.3**	**0.9%**

We think that there may be opportunities for Fire Department savings in a number of different areas:

- Reducing the number of platoons from four to three could result in significant budgetary savings, even if a portion of those savings were shared with firefighters responsible for working longer hours.
- Benchmark analysis suggests that the percentage of FTE positions in Houston Fire Department held by civilians is comparatively low. In particular, the Department should consider implementing the recommendations of a decade-old study that called for civilianizing dispatch positions at the Houston Emergency Center.
- One of every eight calls for service to the Houston Fire Department was a false alarm. To reduce demand on the Fire Department (as well as non-personnel costs of response), the City should consider changing its false alarm fee ordinance. While Houston allows five false alarm calls before levying a fee, San Antonio has a tiered schedule beginning after the first false alarm over the course of a year: in Dallas, the tiered approach is based on the number of calls per month.

In considering opportunities for savings in the Fire Department, it is also important to remember that the vast majority of calls responded to by the Houston Fire Department are not for structural fires. During 2015, 64.3% of all Fire Department responses were for emergency medical calls. Therefore, we are reviewing a series of options for re-thinking the operations of emergency medical services in Houston:

- There is an initial question as to what model of EMS service delivery would be the most efficient and effective. In Austin, EMS is provided by a countywide public authority. Elsewhere in Texas, the public authority model is also active in Fort Worth and other parts of Tarrant County. Atlanta and surrounding communities utilize a hospital-based model of EMS. San Diego contracts for EMS service through a private provider, though the Fire Department is the first responder.
- As a result of incentives under federal law, there are opportunities for the City to partner with local hospitals and insurers in efforts to reduce the number of frequent utilizers of EMS services. Houston already is a national leader on this effort through Project Ethan. Other models, however, exist in Dallas, San Antonio, Fort Worth, and other cities. In all cases, the City should actively seek the financial involvement of economic beneficiaries (e.g. hospitals and insurers). I should note that this is an area where the City has asked that we accelerate our analysis.
- In the short-term and under the current model of service delivery, there may be opportunities to increase cost recovery from EMS. We are reviewing recommendations including an increase in EMS fees, continued improvements in EMS collection rates and new fees from an ordinance that would authorize the Fire Department to bill for non-transport treatment services and transports where patients pass away.

Within the Police Department, we believe there may be opportunities for increased efficiency and effectiveness even as the City works to provide funding for an increase in FTEs. The goal, after all, is not just to increase the number of FTEs but to increase the availability of personnel for patrol.

Police officials and the 2014 PERF report indicated that there were significant opportunities for civilianization. Civilians can perform many activities within a police department – from administrative support to responding to certain non-emergency calls as Police Service Technicians. Simply put, it cost less to perform these activities with a civilian than with a sworn officer. Thus, it is possible to increase patrol strength without hiring new police officers and instead hiring civilians and redeploying sworn officers to patrol

The Police Department will also benefit from savings upon completion of the merger of jail functions between the City and County. The City will also realize savings in health costs related to the Jail, currently funded through Health and Human Services.

21st Century Workforce

To ensure that the City has the police officers, firefighters and other City workers needed to deliver City services, it needs to provide competitive wages to its workers. Through a series of compensation studies in the last five years, the City found that compensation for fire personnel was generally on par with neighboring cities, while uniformed police and municipal employees were both below market competitiveness for minimum and midpoint pay ranges. Without elimination of the revenue cap, the City will not have the ability to raise salaries to keep pace with inflation. Even with elimination of the revenue cap, the City would still be unable to fund salary increases beyond inflation.

We are reviewing a series of potential initiatives that would focus on a gainsharing approach -- whereby additional funding for employee salary is largely the result of increased productivity or reductions in non-salary compensation.

Just as it is doing with pension cost, the City of Houston needs to bend the cost curve on health insurance. Several large local governments are pursuing initiatives in this area with a specific focus on the interplay between employee and spousal benefits. Los Angeles and New York City, respectively, offer "Cash in Lieu of Health and Dental Benefits" and "Health Benefits Buy Out" incentive programs for employees to waive City coverage by obtaining coverage through a spouse, partner, or other eligible avenues. New York City also implemented a dependent eligibility verification audit initiative in FY 2015 that yielded $108 million in savings. Shelby County, Tennessee implemented a Spousal Carve Out provision whereby employees' spouses eligible for health coverage through their employer are no longer eligible for coverage through the County.

Again, following the lead of New York and Los Angeles, we are reviewing possible recommendations that would cap OPEB exposure to inflation or three percent – whatever is less. In 2011, Los Angeles passed a freeze ordinance that gave employees the option of contributing more for post-employment health costs or accepting a monthly cap. We are also reviewing whether the City should consider a more-tiered approach to OPEB based on years of service. Austin, Chicago, Los Angeles and San Antonio have all moved in this direction. In San Antonio, employees with less than five years of service cannot participate in the retiree health program: those with between 5 and 10 years of service can participate, but at full cost and without subsidy.

Operations

Improvements in basic processes in local government can yield also significant – if harder to precisely quantify – savings and revenue opportunities. As the City moves forward with specific initiatives on pension reform, the elimination of the property tax revenue cap, workforce reforms and public safety realignment, it should also focus on some of these core operations to ensure sustained improvements in efficiency.

We are considering a series of recommendations related to the HR or talent management function, information technology, procurement and finance. In each of these areas, we are reviewing the current level of centralization of these functions within City government and the degree to which centralization has been effective and where there may be opportunities for improvements.

As part of our benchmarking analysis, we looked at information technology staffing. Houston has just 8.8 FTEs in HITS per 100,000 residents compared to 10.9 in Los Angeles and 23.1 in San Antonio. Only Chicago, which relies extensively on outside contractors, has fewer IT FTEs in its centralized IT department. Part of the issue, however, is that the City has not fully centralized information technology. Public Works and Engineering, Police, Health and Human Services, Houston Public Library and Parks & Recreation all have some of their own staff performing IT functions.

In HR or talent management, we are also looking at how the City currently invests in professional development for managers and City staff across all departments. Training is often one of the most effective means of increasing efficiency, but it is often sacrificed to budget cuts.

Our analysis to date suggests that there are significant opportunities for cost savings and greater efficiency in the City's procurement process. For example, the City needs to increase its focus on competition in contracting as a way of controlling price. Currently, the City does not effectively track levels of competition on its contracts or have specific strategies for increasing competition.

Finally, while there has been considerable discussion of the decentralized nature of the City finance function, we have turned our analysis to the degree to which the City utilizes special revenue funds. Houston has 30 special revenue funds – many of which go beyond the purposes contemplated by GASB Statement 54, which outlines the accounting basis for creating such funds. By removing these funds from the General Fund budgeting process, it is harder to exercise control over spending. Under the FY 2017 budget, 3,810 FTEs were funded by Special Revenue Funds or Internal Service Funds – this is up by 47.5 percent since FY 2011 and represents more than one-in-five non-Enterprise Fund FTEs.

Coordination and Collaboration

The best, most efficient and effective way to improve service delivery is through coordination and collaboration. We are considering a number of recommendations in this area that go to potential reorganization of certain City functions.

One area that we are looking at -- and this is an area where the City's Office of Innovation of Performance has already done some good work – is the City's 311 system. The City currently has multiple call centers performing similar functions. As an example, Houston 311 is staffed through Administrative and Regulatory Affairs while non-emergency police calls go through the Houston Emergency Center. 311 was initially conceived of as a means of diverting calls from 911. Both Baltimore and Chicago are major cities that use 311 for police non-emergencies. There may be opportunities for savings through a similar consolidation in Houston.

Parks and Recreation, the Library, and Health and Human Services each independently provide community-based facilities with resources and programming for neighborhood residents. Department heads across these three departments have already started to work collaboratively to determine the best possible mix of services in each neighborhood. This approach could be made more formal through a joint planning process for the three departments and the Houston Independent School District on services for young people in Houston.

Culture of Performance

Long-term fiscal sustainability also requires a relentless and ongoing focus on performance. The Ten Year Plan is not a static document. It will require continuous updates – both to adjust revenue and expenditure forecasts and to continuously identify opportunities for efficiency.

Houston already has taken an important step forward with the creation of the Office of Innovation and Performance. OIP functions as a centralized resource of data and works to identify opportunities for operational improvements. To take the next step forward in creating a culture of performance, the City should consider moving forward with a PerformanceStat initiative where the Mayor and senior leadership regularly meet with department heads to review operational and budget issues. These regular meetings will also allow for an ongoing process to identify needed budgetary changes in different departments and will be another means of ensuring greater collaboration and coordination across departments. PerformanceStat processes were born out of the CompStat initiative in the New York Police Department and the CitiStat process in Baltimore.

Houston is also moving toward a more outcomes based budgeting process (also known as Budgeting for Outcomes, or BFO). By setting clear priorities and regularly monitoring data to determine whether the City is meeting those goals, the City can allocate resources in a far more targeted way. BFO also encourages cross-department collaboration and collaboration with non-City entities. Baltimore, New Orleans and Chattanooga – along with other cities – have successfully implemented BFO.

Other cities have worked to foster efficiency on an ongoing basis through Productivity Banks. A Houston Productivity Bank would provide up-front funding for initiatives designed to produce long-term savings. Department heads would be able to seek funding from the Bank for investments in technology and other initiatives designed to produce long-term savings. Under the terms of funding, departments would be responsible for funding repayment based on out-year savings. Both Philadelphia and Washington, D.C. have implemented the Productivity Bank approach. A similar approach – Invest to Save – was implemented in the United Kingdom. The City should also explore partnerships with philanthropy in funding social impact programs that would produce City savings through Social Impact Bonds.

New Partnerships

The opportunity for coordination and collaboration to achieve greater efficiency and effectiveness and savings extends beyond City government. Through partnerships with the private sector, non-profit sector and other local governments, Houston can do more with less.

Managed competition – where City employees compete with the private sector – to perform certain work has been a proven strategy for savings in cities like Chicago and San Diego. Houston already contracts out for certain functions – such as recycling processing, security, janitorial and building maintenance services. As a next step, we are looking at an initiative that would adopt managed competition for other City services – such as street maintenance work currently performed by in-house staff at Public Works and even some additional solid waste services. The Chief Procurement Officer would need to develop a set of policies and criteria for when managed competition should be considered and how competitive proposals should be evaluated.

Chicago, Los Angeles, New York and Philadelphia all generate significant revenue from Market Based Revenue Opportunities (MBRO) where the cities maximize market value of certain assets – through advertising and other uses of City owned sites. Chicago passed a Municipal Marketing Ordinance that authorized creation of a digital billboard network on City highways and advertising on trash cans. The City projected $155 million in revenue over a 20-year period. In New York, a 20-year agreement for advertising on bus shelters, newsstands, public toilets and trash receptacles called for $1.3 billion in revenue.

Partnerships with the non-profit sector – new and old – could also produce savings and new revenue.

Other cities rely extensively on non-profit organizations to provide programming in parks, libraries and multi-service centers. For example, the Seattle Public Library has entered into a series of cooperative agreements with service providers to facilitate language learning opportunities in public libraries. The Broward County Library implemented Career Connect, as a one stop for workforce development in a partnership with the local workforce development provider, Hispanic Unity of Florida and the Broward County Urban League. In New York, six recreation centers are treated as community centers – where the operation and programming is delivered by community based organizations.

Increasingly, other cities are working with valued partners in the non-profit sector – especially higher education and hospitals – to make payments in lieu of taxes. As of 2012, there were at least 218 municipalities in 28 states receiving PILOT payments from non-profit organizations. Boston has multiple PILOT agreements with colleges and other nonprofits located within its borders, which captured $27.9 million in revenue in FY 2015. Providence – a city with less than one-tenth of the population of Houston – projected $7.1 million in revenue from voluntary PILOTs with six non-profits. In a 2015 study for the National Resource Network, researchers from NYU and the Urban Institute outlined the case for how cities and anchor institutions could work together on more strategic efforts, including joint funding for specific initiatives.

Four different city departments – Neighborhoods, Public Works, General Services and Parks and Recreation – all mow grass, one of the most basic functions of city government. Every city mows grass. The City could partner with neighborhood-based organizations to effectively "non-profitize" all mowing – reducing cost and providing employment opportunities for hard-to-employ residents.

Finally, under a lease and operating agreement, the City provides the land and an annual operating subsidy for the Houston Zoo. In FY 2016, the annual subsidy was approximately $9.5 million – having increased from $8.4 million in FY 2011. Operation of a city zoo by a non-profit organization is a best practice and in most cases the operation receives some form of City subsidy. In reviewing benchmarks, however, it appears that the current subsidy agreement between the Zoo and the City is an outlier. The City of Los Angeles has a separate Department of the Zoo, but provides no General Fund support for the zoo. The Lincoln Park Zoo in Chicago is operated with an operating subsidy from the Chicago Park District that is capped at $5.6 million annually. There may be opportunities for the City and the Zoo to extend their partnership into the future in ways that reduce cost.

There are also opportunities for partnerships with county governments and other local government organizations.

The jail merger is just one of many areas where there are overlaps between services provided by the City and local government. Other areas include health, information technology and library services just to name a few. While each of these opportunities need to be carefully reviewed, we are also looking for models for ongoing review of such opportunities. One possible model might be the County-City Shared Services Commission in Cincinnati and Hamilton County, Ohio.

There may also be opportunities for consolidation around law enforcement. In the 1990s, as New York significantly reduced crime, the City moved to consolidate multiple law enforcement authorities into the Police Department. Now, transit police, housing police and school security all operate under the umbrella of the NYPD. We are looking at opportunities for a similar consolidation in Houston.

Next Steps

Between now and the end of June, we will be completing two major tasks.

First, we will complete a round of follow up conversations with department heads to discuss the current list of potential initiatives. The development of a Ten Year Plan is not an academic exercise. Without fully understanding the practical impact of potential changes in policy, program or operations, a good idea on paper can become a disaster in practice. That's why we view the feedback from departments as critical to the development of the final list of initiatives. That does not mean that we will not recommend actions that department heads may disagree with. But it does mean that we have to carefully and fully vet potential initiatives before recommending that they be included in the Ten Year Plan.

Second, once we have a final list of recommended initiatives, we need to go through a careful process of costing the fiscal impact. The goal of a Ten Year Plan is go beyond just a list of ideas and instead identify specific actions with sufficient detail so that City leadership can understand what the fiscal effect of implementation would be. This is yet another reason for the follow up conversations that we are holding with department heads.

Ultimately, while PFM will provide recommendations and analysis and otherwise assist in the development of the Ten Year Plan, this is not our Plan. For the Ten Year Plan to succeed, it has to be the City's plan. It has to be the Mayor's plan, the Administration's plan and ultimately a plan that a majority of the Council supports. Moreover, the Plan is specifically designed to be about more than just one year or one budget. The vast majority of the recommendations that we will make in the Ten Year Plan will not have a Year 1 impact. The whole point of looking at budget issues beyond the narrow bounds of a single budget is to allow city government to focus on immediate actions that can have long term – though not necessarily immediate – benefits. Finally, the Ten Year Plan cannot be viewed as a one-time event. It has to become something that the City does on a regular basis – because as we all know, plans change over time.

Conclusion

In moving forward with pension reform and elimination of the property tax revenue cap, the City is taking necessary steps to eliminate its projected structural deficit over the next ten years. If the City builds upon this platform by adopting many or most of the initiatives that I have outlined today – and others that will be in our final recommendations – it will have sufficient resources to make needed investments that produce new savings and grow the Houston economy.

If pension reform and elimination of the property tax revenue cap do not go forward, Houston would face a far different path. At this point, it is not clear that the City can easily cut its way out of the multi-billion dollar budget hole that it faces. The City would need to fully implement all of the steps we have outlined to increase efficiency and effectiveness. But it would have to do more.

Rather than a phased reduction in the number of firefighters, the City might have to resort to layoffs. Firehouses would likely need to be closed or at least browned out.

The City would need to consider cuts in library services, reduced hours or closings at community centers and multi-service centers.

Rather than going to fund salary increases, reductions in employee health benefits would be needed to balance the budget. And there would be little if any funding available for the additional investments outlined above.

The City would also need to explore every other means available to it to increase fees and other charges for City services to offset lost revenue due to the property tax cap.

Houston is at a crossroads. Decisions to change the City's approach to funding pensions and to remove the self-imposed cap on revenue growth are critical to the City's long-term fiscal sustainability and economic health. These decisions alone, however, will not provide sufficient funding to achieve all of the objectives set forth by the City's leaders. And, in the absence of pension reform and changes in revenue policy, the City would need to take steps to achieve fiscal balance that could put its long-term economic competitiveness at risk through reductions in City services that directly affect quality of life. Doing so could lead to a downward spiral of population decline, increased concentration of poverty, an increase in demand for services at the same time that the tax base would shrink in ways that would make funding those services impossible.

Thank you for this opportunity to brief the Council. The PFM team looks forward to providing our final findings and recommendations. And I would be happy to answer any questions that you may have.