HARRIS COUNTY, TEXAS

COMMISSIONERS COURT

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Ed Emmett	Rodney Ellis	Jack Morman	Steve Radack	R. Jack Cagle
County Judge	*Commissioner, Precinct 1*	*Commissioner, Precinct 2*	*Commissioner, Precinct 3*	*Commissioner, Precinct 4*

January 26, 2018

To: County Judge Emmett and
Commissioners Ellis, Morman,
Radack and Cagle

Re: **FY 2018-19 Budget Presentation**

The proposed budgets and policy issues for FY 2018-19 are presented for discussion. The court is scheduled to consider this information on January 30 and adopt the budgets and any new policies after a public hearing on February 13. The new budgets will be effective for the fiscal year beginning March 1, 2018 through February 28, 2019.

Proposed County Budgets

A discussion of the County's finances is attached along with a summary of the Auditor's preliminary estimate of available resources and the proposed budget allocations for the General, Mobility and Public Improvement Contingency funds. Budgets for debt service, grants, special revenue and other funds will be presented for court approval along with the Auditor's final estimate of available resources on February 13.

Debt Service Funds

Resources will be allocated to the appropriate debt service funds to meet the debt service requirements for Harris County, Harris County Flood Control District, Harris County Toll Road Authority, the Harris County Hospital District and Port of Houston Authority of Harris County.

Flood Control District

The Flood Control District will continue the plan to allocate $60 million for operations and $60 million for capital projects for FY 2018-19. Discussion of other potential funding sources for flood control projects is included.

Harris County Hospital District

The budget for the Harris County Hospital District will be presented for court approval in February.

Port of Houston

The Port of Houston debt service will be addressed with the February 13 presentation.

Policy Issues and Proposed Budgets

The following is presented for consideration as part of the proposed FY 2018-19 budget.

Population Growth and the Local Economy

Harris County continues to experience significant growth in population. The nation's third largest county has grown from 3.4 million residents in 2000 to nearly 4.7 million by the end of 2016. Most of the increase in population (over 75%) has occurred in the unincorporated areas of the County. The unincorporated area would be the second largest city in Texas (behind Houston) and the fifth largest city in the U.S. if it were incorporated. By 2020, the unincorporated population is expected to actually exceed the City of Houston population within Harris County.

The need for new roads and infrastructure to support this growing and diverse unincorporated area will continue, as will the need to deliver all manner of public services and cost effective tools for law enforcement. County government plays the primary role in making this happen.

Maintaining a Strong Balance Sheet

Limited Growth in Expenditures

Over the last ten years, Harris County has experienced both periods of steady decline in revenues (FY 2009-2013) and then steady increase in revenues (FY 2014-2018), without any change or increase in the property tax rate. General Fund revenues over this period have grown by an average of 4% per fiscal year. Most of the added revenue is a result of new construction and increases in the market value of homes and buildings that have added to property tax revenue.

General Fund expenditures have grown by an average rate of less than 2% per year during the last decade. Budget allocations have kept pace with revenue growth but the policy allowing departments to roll over unspent funds at the end of each fiscal year has helped slow down the actual spending to 1.9% per year. Most of the growth has occurred in law enforcement and the administration of justice.

The amount of budget rolled over by departments has grown each year to over $100 million overall. Departments are considering spending some of the rolled over funds in the upcoming fiscal year and it is their decision on how much to spend. It is important to keep in mind when using rollover funds to add personnel or increase salaries that these increases need to be sustainable over a longer period of time in case future budgets are impacted either by lower revenue growth or legislative limitations on growth.

Cash and Short Term Debt

Harris County has continued to make significant progress in improving the county's financial condition and strengthening its balance sheet. Cash balances in the General Fund have grown from $149 million at the end of FY 2012 to an estimated $980 million by the end of FY 2018. It is important to point out that the county's fiscal year end of February 28 is the traditional high point for cash balances each year, due to the timing of property tax collections. The low point in cash balances is typically in November each year.

In the years prior to FY 2017, the County issued Tax Anticipation Notes (TANs) to fund the cash shortfall that occurred each year. A concerted effort was made starting in 2012, with TANs borrowing approaching $500 million, to improve the county's financial condition to eliminate the need to borrow funds during the year. This effort resulted in annual reductions in TANs borrowing until they were eliminated in FY 2017. This was accomplished primarily with the funds saved through the rollover policy and conservative budgeting to grow expenditures at a slower pace than revenue.

Financial policies are in place to continue to maintain financial stability and strength. Harris County currently has the highest rating from each of the major rating agencies. Controlled spending combined with managing debt obligations are key to maintaining these high ratings.

Long-Term Debt

The County's long-term debt includes bonds issued to build roads, buildings, parks, libraries, flood control and other infrastructure projects that are repaid directly with property tax revenues. Property taxes also support repayment of bonds issued by the Flood Control District, the Hospital District, and the Port of Houston. Other long-term debt issued by the Harris County Toll Road Authority and the Hotel Occupancy Tax are repaid by revenues or fees and do not involve property tax revenue.

In November 2015, voters authorized the issuance of $848 million of new property tax supported bonds for roads ($700M), parks ($60M), a building ($24M) and flood control projects related to new roads ($64M). Commercial paper has been established in all of these areas and will be spent and then refunded with the issuance of bonds over the next several years as needed.

Budget Management continues to work to accomplish the goals of maintaining a stable long-term debt level without any increase in the property tax rate or increase in the tax supported debt per capita. Limiting the rate of borrowing to match existing debt principal reductions each year along with a factor for population growth is a strategy to help accomplish these goals. Considering the total cost of ownership and attempting to finance new assets over their estimated useful lives will help the county continue to meet the infrastructure demands for an expanding population.

Budget Management will continue to work with the County's financial advisors with this strategy and to monitor financial markets and identify opportunities to manage existing debt obligations.

Available Resources for the FY 2018-19 Budget

Revenue Budget

Property taxes provide 79% of general fund revenues, all of the general debt service obligations, most of the Flood Control District's budget, over $50 million for Port of Houston debt service and about $700 million for the Hospital District. Over the last 10 years, county population has grown by more than 700,000 residents while the per capita General Fund expenditures have remained virtually unchanged. In FY 2009, the county spent an average of $347 per county resident in the General Fund, which is the same amount per resident in the current fiscal year. The tax base has expanded with new housing, significant commercial and industrial growth over this time frame along with some increases in the value of existing property.

The Auditor's preliminary revenue estimate includes a 0.3% decline in general fund revenues for FY 2018-19 compared to the estimated revenue for the current fiscal year. Until the appraisal process is complete, it is difficult to estimate the impact of Hurricane Harvey on the homes and businesses that were flooded in late August. Many of these properties have not been fully repaired and their market values as of January 1, 2018 could be significantly lower than they were a year ago. This could be an issue for just one fiscal year assuming many of the damaged buildings will be fully repaired and occupied by January 1, 2019. General Fund revenues are expected to remain flat overall, although there could be a decline overall depending on how the damaged properties are appraised.

Expenditure Budgets

The preliminary general fund budget allocations are included. These budgets will be finalized and balanced to the Auditor's final revenue estimate and presented for court approval on February 13.

General Fund expenditure budgets for county departments are 2.4% higher than last year's adopted budgets. The proposed budgets include $676 million for law enforcement, $463 million for the administration of justice, $170 million for infrastructure and systems administration and $182 million for county, fiscal services and purchasing. A majority of the growth in spending over the last few years has been for law enforcement and the administration of justice, which make up 76.4% of departmental budgets.

Labor and Benefits

Labor and benefits make up 71% of all general fund expenditures. Despite the estimated decline in general fund revenues for FY 2018-19, the proposed general fund expenditure budgets have been increased and should provide funding for departments to cover at least currently filled positions. Requests to fill vacant positions or to add new positions will be considered based on the department's budget allocation and financial status.

The cost of health insurance is expected to increase and the annual cost allocated to departments is increasing from $13,000 to $13,650 as a result. The retirement plan contribution is expected to increase from 14.0% to 14.5% of payroll. With the strong performance of the stock market for 2017, the percentage funded for Harris County in the statewide retirement plan probably will increase from the 88% funded as of the end of 2016.

Operational Issues

Law Enforcement and Contract Patrol Services

The Harris County Sheriff's office is on track to have improved financial results for FY 2018. The new Joint Processing Center is expected to open this spring and will require some new staffing by the Sheriff's office which has not been added to their budget. Adjustments to fund these new positions will be proposed in advance of the opening. The City of Houston is paying for 30% of the cost of the facility along with an agreed upon share of the operating expenses based on case volume.

The eight Constables are also operating within budget. Projects to improve security at some of the County annex locations are in progress and evaluation of requests to add bailiff positions in some locations are being considered.

The rates charged for contract patrol services will increase 3% on March 1, 2018 as adopted in February 2017. Budget Management recommends that Court consider approving no increase in contract patrol rates effective March 1, 2019.

New Enterprise Resource Planning (ERP) system

Harris County is proceeding with the implementation of a new ERP software system that will replace the IFAS accounting system originally installed in 1999. The ERP system is expected to be installed within the next 15 months with the Human Resources and Payroll sections going live on July 1, 2018 and the main accounting system going live on March 1, 2019, the first day of the county's 2019-20 fiscal year.

Some policies may need to be adjusted related to the new systems and they will be presented to Court as needed in the next few months.

Audit Review Committee

The County Auditor has agreed to support the formation of an Audit Review Committee that will meet periodically to provide feedback and assistance to the Auditor particularly related to internal audit activities and the external audits of the county and related entities. Budget Management agrees and will bring back a proposal as a regular agenda item.

Hurricane Harvey Flooding Impact on Harris County

Harris County was impacted by the flooding that resulted from rain associated with Hurricane Harvey. Four major buildings and a number of smaller structures owned by the county were flooded, including the Criminal Justice building and Jury Assembly buildings downtown along with annex locations at Clay Road and Cypresswood. Alternative facilities were operational within two weeks of the flooding to provide all of the necessary services to the public.

The county has submitted claims with FEMA for $180.1 million for facilities and operations to date and has received $64.6 million or 36% of those claims from FEMA and the State of Texas. Claims for $20.4 million have been submitted so far to the Federal Highway Administration for roads, bridges and traffic signals. The Flood Control District also has FEMA claims for $32.7 million. A total of $16.6 million has been received so far from flood insurance coverage.

The Public Improvement Contingency (PIC) fund has been used to fund the costs incurred so far related to Harvey and a grant fund was also set up to manage the $44 million received from FEMA for debris removal in the unincorporated area along with reimbursing the county for overtime incurred of which $9 million was paid for law enforcement.

The other major impact of the flooding is related to the HCAD appraisals of all of the flooded property as of January 1, 2018. Many of the homes and businesses have not yet been repaired and the effects of a significant lowering of taxable value related to these properties could be significant. HCAD estimates that they expect the net effect to result is an overall zero growth rate in the tax levy. The total impact for this budget year will be known by the July or August of 2018 when HCAD provides the certified tax levy.