



Houston Experience

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Note: The following comments and opinions are offered as accounting and legal laypersons, not as licensed CPAs or attorneys.

Summary

Houston voters' experience with the voter-approved 2004 Proposition 2 Amendment to the City of Houston Charter is a textbook illustration of the lengths to which elected officials, power brokers, lobbyists and those doing business with a governmental entity will go in order to deny taxpayers overall control of monies they have entrusted to elected officials.

Proposition 2 (Prop 2) simply requires that the City obtain voter approval before the City increases its total revenues by more than the combined rate of increase in population and inflation. It does not prevent anything per se, it merely requires voter approval before the City expands its revenues in any given year beyond the very reasonable corral of the combined growth rate in population and inflation.

The Prop 2 voter-initiated petition was submitted to the Houston city secretary on September 7, 2001 but was stonewalled by the City until it was placed on the November 2, 2004 ballot as Proposition 2.

Prop 2 predictably passed in every city council district on November 2, 2004. Nevertheless, voters had to sue in order to get Prop 2 actually placed into the City charter. But the City then refused to enforce Prop 2.

The voters then had to sue to try to make the City actually enforce Prop 2, which the City still has not done. The matter was placed in the hands of the Texas Supreme Court August 18, 2008, with the only apparent residual (specious) issue being whether the voter plaintiffs (who voted for the petition, financed it, and directed its PAC petition gathering efforts) have standing to sue.

Finally, on August 26, 2011, the Texas Supreme Court declined to give a final ruling on the issue of standing, stating that the case (08-0658) had not "ripened", in other words plaintiffs had shown no injury. The voter plaintiffs apparently are now evaluating whether and how to go forward.

In the meantime, while the City has spent untold thousands of taxpayer dollars since 2004 in denying the will of the voters, the City has had operating losses of approximately \$2.4 BILLION for fiscal years 2004-2011 (\$1.5 BILLION occurring before the 2008 Great Recession hit Houston). Yes \$2.4 BILLION, even though the City had record revenues during most of those years from property taxes (2003-2010) and sales taxes (2004-2009).

We trust that your city charter or state constitutional amendment attempt will benefit from fully reading about the Houston experience. This is a somewhat lengthy article, but we believe it is well worth the read.

The attached Finance Corral city charter amendment proposed for your use is the Houston November 2004 Prop 2, revised to provide for lessons learned in the Houston experience.

Prop 2 History

Prop 2 came about in the following manner and has had the following history since passage.

Tax Vote 97. A somewhat similar ballot measure, Tax Vote '97, failed to pass in November 1997, apparently principally due to the fact that it attempted an inflation cap on every single tax or fee. Prop 2 overcomes this micromanagement objection by taking a macro-management approach of simply placing a population plus inflation increase cap on the City's total revenues.

Citizens for Public Accountability. After Tax Vote 97 failed, a group of retired partners of some of Houston's accounting firms formed a bipartisan taxpayer advocacy group called Citizens for Public Accountability. The founders included retired CPAs who were not only still very active in their professional societies and civic organizations but also in both the Democrat and the Republican parties.

CPA's original purpose was and still is to furnish Houston-area voters financial information relevant to selected local, state and federal voter issues. Of some relevance, CPA founders included a Democrat member who had served Republican President Richard Nixon's Grace Commission, created to review the federal government's finances, and a Republican member who had served Democrat Texas Governor Mark White's "mini-Grace Commission", created to review the finances of the State of Texas.

Soon after its formation, CPA became very disturbed by the trends in the finances of the City of Houston and decided that they would be derelict if they did not use their backgrounds to help the City address its growing financial problems. Accordingly, they attempted to meet with Houston city council's budget and fiscal affairs committee and present a veritable laundry list of what CPA perceived as significant instances of fat in the City budget. The then chairperson of the City's committee (now the mayor of Houston, after serving six years as city controller) absolutely refused to permit CPA to meet with city council's committee.

Writing and gaining voter approval of Prop 2. Therefore, CPA decided that a city charter amendment was vitally needed. So the chairman of CPA wrote a proposed amendment and the other CPA members subjected it to review and critique. The chairman then made a number of presentations to civic organizations. One meeting piqued the interest of some local businessmen, who formed a non-partisan PAC, Let the People Vote. The PAC prepared a petition containing the CPA proposed amendment to the city charter, with some minor but important wording changes, and obtained over 30,000 voter signatures (only 20,000 were required).

Obtaining and validating the petitions was a very tedious and time consuming process. This was accomplished through the tremendous time and effort of many volunteers, such as members of the Houston Property Rights Association. In this electronic age a decade later, means exist to significantly reduce the time and effort spent toward obtaining and verifying required petition information.

The signed petitions were submitted to the Houston city secretary on September 7, 2001 but were not certified by her office until October 25, 2001. The certification was not soon enough to get the petition on the early voting ballot for the November 6, 2001 election, which also contained state and federal ballot issues. Supposedly other issues on the city portion of the ballot were submitted prior to the citizen-initiated petition and the mayor apparently refused to furnish the city secretary's office sufficient additional personnel (out of over 20,000 other city employees) to do the simple signature verification procedure in a timely manner.

So voting on the voter-initiated petition was stonewalled by the city regarding 2001.

The law requires a two year wait after a Houston city charter change is approved before another proposed Houston city charter change can be placed on the ballot. Since another proposed city charter change was approved on the November 6, 2001 ballot, the citizen-initiated petition could not go on the ballot until November 2003. The 2003 election Tuesday was on November 4, 2003. So the city stonewalled the petitioners again, by saying that November 4, 2003 fell two days short of being two years, to the exact day, after November 6, 2001.

In 2004 the city could no longer delay the petition vote and it was placed on the November 2, 2004 ballot.

City officials and those opposing the petition knew from political polling that the petition had very strong support and its passage was highly likely. Thus the city's total revenues apparently were held in compliance with the coming revenue cap for fiscal years ending June 30, 2002-2004 (The city and its backers knew that the forthcoming first fiscal year under the petition was required to be indexed back to the fiscal year 2001 total revenues and the 2000 federal census).

A new Houston mayor took office in January 2004. The new mayor had met with three of the petition backers in March 2003 and received a full briefing on the petition's proposed city

charter revisions but the mayor declined to back the petition. After the new mayor took office, the CPA group twice sent a written offer to assist him in understanding the city's finances, the obviously bloated past budgets, and the remedial city charter change petition. But the mayor declined to respond.

The new mayor then commenced strongly opposing the petition and finally got a very suppliant city council (in Houston's strong-mayor form of government) to directly place a supposedly competing proposal on the November 2, 2004 city ballot. According to his legal prerogative, the mayor designated his proposal as Proposition 1 (Prop 1) and the citizen-initiated proposal as Proposition 2 (Prop 2).

Whereas the citizen-initiated Prop 2 placed a population plus inflation increase cap on the City's total revenues, the mayor's proposed Prop 1 placed a population plus inflation cap on total property tax revenues and on water and sewer rates (population is a redundant application to a water and sewer rate increase, in other words, an automatic "double dipping").

Although the mayor declined to ever publicly debate the merits of Props 1 and 2 he made constant comments in the media touting the supposed merits of his Prop 1 and the supposed dire consequences of the voter-initiated Prop 2. Prop 1 received a tremendous funding advantage, from the power-brokers and those doing business with the City, as well as the mayor's own wealth.

The Prop 2 backers considered both Props to be good for the City, but touted that "Two" was more than "One".

It appeared obvious that both Props were going to pass. So City officials were desperately scrambling. This was evident in an October 26, 2004 (7 days before election day) secret memo that the City's director of finance sent to the mayor, describing a supposed "loophole" that the director had found in Prop 2 wherein the City might be able to get around the Prop 2 cap. The mayor then forwarded the memo to his City employee public spokesperson suggesting that a certain Houston Chronicle reporter might be interested in the loophole subject. The City employee public spokesperson had just retired in 2004 as chairman of the Houston Chronicle editorial board and gone to work for the City as the mayor's spokesperson. The mayor and the director of finance obviously were working against the public interest instead of for it.

Both PROP 1 and Prop 2 were approved by the voters on November 2, 2004. Prop 1 was 280,596 for and 158,152 against. Prop 2 was 242,697 for and 187,169 against. Prop 2 was approved in every city council district and by every political and demographic group.

City refusal to insert Prop 2 into the city charter and then refusing to enforce Prop 2. The mayor immediately stated that Prop 2 would not be inserted into the city charter as it was in conflict with Prop 1 and Prop 1 received the most votes and that thereby made Prop 2 not in effect. The mayor never offered any public evidence of conflict between Prop 1 and Prop 2, regarding enforceability conflict or financial number conflict. The City's audited annual financial

statements, before the vote and after have never reflected any enforceability or financial number conflict.

Some Prop 2 voters brought suit directly to a state appellate court, which immediately ordered the city to put Prop 2 into the city charter, which it finally reluctantly did, and Prop 2 remains in the city charter today.

However, the mayor refused to actually enforce Prop 2 and it is still not enforced to this day.

After the mayor was forced to place Prop 2 into the city charter and refused to enforce it, a group of voters brought suit in a state lower court requesting that the city be required to enforce Prop 2.

The city filed a request for summary judgment to dismiss the plaintiff voters' suit. The judge denied the city's request but then accepted a subsequent voter plaintiffs' request for summary judgment to force the city to enforce Prop 2.

The city appealed the lower court acceptance of the plaintiff voters' request for summary judgment, the city claiming that the voter plaintiffs had no standing to sue. The appellate court upheld the city's assertion of no standing, first by a three-judge panel and then by a ruling of the entire group of judges assigned to that appellate court.

The voter plaintiffs then appealed the appellate court ruling to the Texas Supreme Court on August 18, 2008. The only issue that finally ended before the Texas Supreme Court was---Do the voter plaintiffs have standing to bring suit against the city requiring enforcement of Prop 2? That would seem to be a very specious issue, in that the plaintiff voters were involved in: (a) writing Prop 2; (b) promoting and funding passage of Prop 2; and (c) voted for it.

The plaintiff voters are Houston businessmen Bruce Hotze and Jeff Daily along with Carroll Robinson, Texas Southern University law professor and former Houston city council member.

On August 26, 2011, the Texas Supreme Court finally ruled (Case 08-0658) that the Court did not have jurisdiction in that the case "was not ripe". In other words, the voter plaintiffs had not presented and proved that they had incurred damages.

The Court could have easily ascertained, from simply reading the Prop 2 charter amendment in question, that no one could yet assume whether the case was "ripe" or not because the arbiter (in effect), the independent audit firm, has yet to positively opine in writing whether the City has a liability to the taxpayers. See below.

It appears that the voter plaintiffs are assessing what, if any, further legal avenues should be pursued. We will advise you as to further developments, if any.

Does the City of Houston have unrecorded Prop 2 liabilities

due to the taxpayers? You be the judge.

The chairman of Citizens for Public Accountability (CPA), the basic author of Prop 2, made an open records request of the city regarding the city's possible Prop 2 liability to the taxpayers for fiscal year ended June 30, 2006 (the first fiscal year to which Prop 2 applied). Based upon city controller department documents he has obtained, he believes that the city owed taxpayers a total Prop 2 refund of \$31,196,742 as of June 30, 2006 (which has never been recorded and now has accrued interest due thereon).

He bases his belief on a city controller department prepared document he obtained that supposedly shows that the city had no Prop 2 liability as of June 30, 2006, but in his mind:

- (a) Improperly offset revenues in excess of the Prop 2 cap for regarding expenses incurred regarding Hurricane Katrina and Hurricane Rita, over 99% of such expenses were reimbursed to the city by FEMA. He believes that not adjusting for the reimbursements from FEMA resulted in improper "double dipping" by the city.
- (b) Improperly eliminates base year 2001 and (greatly increased) 2006 revenues from water sold to other governmental entities, a large net result favorable to the city. This resulted from what he believes was an improper legal interpretation of accounting terminology by the city's legal department. Bear in mind, the CPA chairman wrote the Prop 2 language in question.

The city controller department documents referred to above, supposedly showing the city had no Prop 2 liability as of June 30, 2006, were dated June 10, 2007, AFTER the auditors' June 6, 2007, yes 2007, report on the city's June 30, 2006 financial statements. Therefore, neither the city controller department, which prepares the annual financial statements, nor the audit firm could have had knowledge of these documents (showing that the city supposedly had no Prop 2 liability at June 30, 2006) when the June 30, 2006 audited financial statements were released on June 6, 2007.

(It is extremely difficult to understand how, under generally accepted auditing standards, the audit firm could have relied upon the June 10, 2007 document for releasing its audit report dated June 6, 2007.)

The only documents previously furnished under an open records request regarding any possible Prop 2 liability at June 30, 2006 was a document prepared by the city controller department on 12/8/2006 that showed that the city did, in fact, have a Prop 2 liability of \$3,682,757 as of June 30, 2006 and the document did not have the later claimed hurricane and water sales adjustments therein.

The CPA chairman, primary author of Prop 2, attempted to dialog with the local partner in charge of the city's audit, the executive in charge of the Houston office of the audit firm and the national executive in charge of the firm. They declined and the partner in charge of the city audit verbally advised the CPA chairman/Prop 2 author that the partner in charge of the city audit would need the city's permission to talk to him, thus apparently permitting the client to

dictate the audit firm's scope of examination. It is unknown how this was determined not to be in violation of generally accepted auditing standards.

After this stonewalling experience, the CPA chairman saw no purpose in attempting to ascertain possible Prop 2 liabilities for fiscal years following 2006.

Prop 2 requires that the city's audit firm furnish an annual report stating positively whether the city complied with the Prop 2 cap for the fiscal year just audited and, if not, by how much not. The city's audit firm apparently has yet to furnish such report for any year since Prop 2 has been the law.

**Does the City of Houston have unrecorded Prop 1 liabilities
due to the taxpayers? You be the judge.**

The mayor's Prop 1 approved by city council and then by the voters in November 2004 appears to have been a last-minute cruel hoax perpetrated upon Houston voters, for, like Prop 2, it has never been enforced either.

It appears that Prop 1 was placed upon the ballot only to hopefully defeat the citizen-initiated Prop 2.

Recall that Prop 1 provides for an annual population plus inflation adjustment cap to total property tax revenues and to water and sewer rates. The first effective year for Prop 1 was fiscal year ended June 30, 2006.

Total Property Tax Revenues. The city chose to use budgeted total property tax revenues rather than actual total property tax revenues in determining compliance with Prop 1. The city did this although budgeted revenues was never proposed in the ballot language, the enabling ordinance, public discussions or debates by the mayor, city council members or their spokespersons, nor has the budget aspect ever been mentioned in the description of the Prop 1 limitation in the footnotes to the city's audited annual financial statements.

In the years prior to fiscal year ended June 30, 2006, the city's budgeted and actual total property tax revenues were extremely close in amount. That was because by the time the annual budget is finally officially adopted in the fall of each calendar year practically all tax protests are settled and the final upcoming January tax roll is essentially settled upon.

Commencing with fiscal year 2006 and then every year thereafter, the city's annual budgeted total property tax revenues became significantly less than the actual total property tax revenues. And, voila! The budgeted revenues managed to always be within the allowable (budgeted) Prop 1 increase!

Clearly, from day one, the city elected officials had no intention of complying with the total property tax revenue cap in their own Prop 1 and Prop 1 was a fraud.

We have not computed the city's probable Prop 1 liability to the taxpayers. But it should be substantial, because the city had record growth in total property tax revenues in every fiscal year 2006-2010.

Water and sewer rates. The city appeared to comply with Prop 1 relative to water and sewer rate increases until 2011. Then in 2011 the city implemented water and sewer rate increases apparently averaging about 30%. This was clearly in violation of Prop 1.

The city filed suit (essentially against itself) in an Austin court requesting the rate increases under a state law which requires that municipal utilities always increase their rates sufficient to create net revenues sufficient to cover debt service, irrespective as to how profligate increases in the city's utility operating expenditures.

The presiding judge ruled, in effect, that state law trumped city charter law and granted the city's huge water and sewer rate increases. So the water and sewer rate supposed Prop 1 cap also was a fraud against the voters from day one.

Ignoring of Prop 1 and Prop 2 by both the City and the Audit Firm

Both Prop 1 and Prop 2 are in the City Charter, verbatim, due to the unanimous order of a three judge state appellate court. But no Prop 1 or Prop 2 liability has ever been recorded on the books of the City in any year since Prop 1 and Prop 2 became effective, and the audit firm has never taken exception, apparently at least not in publicly available documents, to the lack of any such possible unrecorded liabilities. At least for fiscal year ended June 30, 2006 (first fiscal year covered by Props 1 and 2), both the city and the audit firm totally ignored even the existence of both Prop 1 and Prop 2 in their "letter of representations" that generally accepted auditing standards require that they furnish each other at the end of an audit. So it appears that neither the City nor the audit firm recognize even the legal existence of Prop 1 and Prop 2.

Lessons Learned From Prop 2

1. Elected officials must face stiff financial consequences, out of their own pockets, for impeding the placement of a voter-approved city charter amendment into the city charter and/or impeding enforcement of the voter-approved city charter amendment. **Subsection Ten** of the attached suggested city charter amendment ([CLICK HERE](#)) furnishes that stiff financial consequence.
2. Putting a cap just on revenues will not prevent out of control unpaid expenses. The city will just run up unpaid funding of pensions resulting from greatly expanded benefits and unfunded costs of rapidly rising employee health care benefits, etc. **Subsections Two and Five** of the attached suggested city charter amendment ([CLICK HERE](#)) provide means of preventing further increases of deficits in unrestricted assets and unreasonable growth in long-term liabilities.
3. The city must have the ability to make emergency expenditures immediately needed due to federally declared disasters. However, the city must not be allowed to "double dip"

regarding disaster relief monies received from the federal and/or state governments by also increasing their allowable revenues under the Prop 2 city charter amendment and then not giving taxpayers relief to the extent the city is reimbursed by the federal and/or state governments. **The third paragraph of Subsection Three** of the attached suggested city charter amendment ([CLICK HERE](#)) remedies this problem.

4. There must be no question as to what revenues may be excluded from the city's total revenues in making the Prop 2 cap calculation. **Subsection Nine** of the attached suggested city charter amendment ([CLICK HERE](#)) makes the allowable exclusions very clear.

Lessons dearly and expensively learned, but the mentioned strengthening wording should greatly reduce the possibility that you will encounter a frustrating experience like the good people of Houston.

GOOD LUCK IN YOUR PETITIONING EFFORTS!