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Houston's Audit Underscores Ongoing Financial Challenges.

Executive Summary

The City of Houston's Annual Comprehensive Financial Report (ACFR) for FY2023-2024 highlights the City's ongoing financial challenges, despite short-term improvements in its net position.

While the City reported record revenues of \$7.3 billion and a \$1.3 billion surplus last year, much of that improvement was driven by business-like activities, such as the airport and water systems. In contrast, the governmental fund continues to have a large unrestricted net position deficit of \$4.9 billion.

Although there have been improvements in pension liabilities, the City remains burdened by the contributions required to fund its pension and debt service on pension bonds taken out to shore up the funds.

Grant income has seen dramatic growth since 2018, reaching an astonishing 35% of all revenue by 2022. However, this increase has begun to reverse, as grants decline toward historical levels, raising concern about the City's reliance on these funds.

Compounding these financial pressures, the City's population has stagnated since 2017, threatening its ability to grow its tax base.

In addition to these challenges, the City's General Fund faces further strain due to two significant legal rulings last year. First, a settlement with firefighters over backpay resulted in a one-time expense of \$650 million, phased in over the next five years and increased firefighter compensation going forward. Second, the City lost a lawsuit resulting in an order mandating transfers from the General Fund to the Dedicated Drainage and Street Renewal Fund (DDSRF) of roughly \$100 million annually.

The Combined Utility System (CUS) has shown financial improvement, primarily due to a series of rate increases. Still, it continues to face infrastructure challenges, highlighted by a consent decree with the Environmental Protection Agency (EPA) that requires billions in investments for improvements.

Tax Increment Reinvestment Zones (TIRZs) remain a significant issue, as they continue to divert a growing portion of property tax revenue away from the General Fund, complicating Houston's financial landscape. Last year, the diversion to the TIRZs reached \$200 million for the first time.

Houston's fiscal outlook remains precarious, requiring urgent structural reforms to address long-term budget imbalances, manage pension liabilities, and secure sustainable funding for critical infrastructure needs.

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