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March 27, 2020

The Honorable Mayor Richard W. West and Members of City Council
City of Chesapeake, VA

Dear Mayor West and Members of City Council:

It is my privilege to present the Proposed Operating Budget for Fiscal Year 2021. As always, our goal is to present a balanced budget that not only ensures annual operating costs do not exceed ongoing resources, but also addresses the City's existing and future needs.

It is important to note that this budget was largely finalized in the first week of March, prior to the coronavirus pandemic declaration. As such, the revenues and expenditures are based on information that was available through the end of February. However, as we are now in the midst of an unprecedented global event, we are faced with significant challenges that must be addressed.

While this budget is focused primarily on maintaining existing levels of service, ensuring compliance with mandates and obligations, and addressing employee compensation, we will need to very closely monitor revenues and expenditures over the coming months and make revisions as necessary.

The budget totals \$1.16 billion and reflects our plans for activities that will take place starting in July. Resources to support City services are closely tied to economic activity in the City and State funding of public schools. While projections earlier in the year indicated that the regional economy would continue to improve and that City revenues would continue to grow, the rate of growth is slowing. These changing revenue conditions will be particularly acute in the short term. Depending on the duration of the pandemic, this could put pressure on our capacity to provide certain services. Prior to the pandemic declaration, General Fund revenue was projected to grow 3.1% in FY 2021 as compared to growth of 3.6% that was projected for FY 2020. However, as noted above, we are in uncertain times and as such we must closely monitor revenues and spending and make adjustments accordingly for the foreseeable future.

The overall spending plan grows by 4.6% (or \$51.0 million) to \$1.16 billion. Most of the growth (\$45.6 million) is in the school portion of the budget (spending on schools increases 8.6%). By comparison, spending on City services rises by just \$5.4 million (0.9%) above the FY 2020 budget. This is due, in large part, to the types of revenues shared between the City and Schools and the variable rates of growth within our revenue streams (e.g. state support for schools has increased year over year). Given our commitment to the school funding formula, our commitment to our employees, and our need to be careful stewards of taxpayer resources, particularly in the face of economic uncertainty, there is little current capacity for significant new initiatives.

In 2010, City Council identified several guiding principles that provided direction for budget development during the last ten years. The guiding principles include:

- No increase in the real estate tax rate;
- No new fees (though increases in existing fees may be considered);
- No supplanting of losses in state or federal funds with local revenue;
- Review of all vacant positions for possible elimination;
- Identification of operating inefficiencies and reduction of spending accordingly; and
- Identification of non-core services for possible consolidation, curtailment or elimination.

The budget planning process largely began in September 2019. We canvassed departments for their budgetary requirements for the next three years. Departments identified over \$37 million of needs for next year (which when aggregated would total approximately 6.4% of the adopted FY 2020 Operating Budget). We then met with leaders of every department to better understand their budget metrics, identify how service demands impact their budget, and discuss resource needs for the next several years. While this was very informative, at this time revenues are insufficient to accommodate the majority of those requests. However, we did ask departments to look at their current budget to identify areas which are less important than those which they've proposed and where they would recommend reprioritizing resources to provide different services. In addition, we asked every Director to identify ways we could operate more efficiently and use fewer resources. We were able to use that feedback to strategically identify savings that would not impact service delivery. As we move through the next few months, this work will continue.

Budget Drivers

The FY 2021 Operating Budget is heavily impacted by a relatively small number of issues. The primary issues influencing the budget are as follows.

Slowing Revenue Growth – The pre-pandemic declaration estimate of revenue growth across all funds is projected at 4.6%; however, most of the growth is in state and federal payments to the Chesapeake Public Schools. The budget assumes revenue for schools increasing by 8.7% next year compared to 2.5% for the City. The City's General Fund, which supports most of the City and the Schools, is projected to grow by just 1.8%.

School Revenue Sharing Formula – the City has a long history of equitably sharing tax revenues with Schools, and this budget continues that tradition. While the revenue sharing formula reasonable, it is placing some stress on the City given that shared revenues are growing faster than revenues that are not shared. While General Fund revenue is expected to grow 1.8% in FY 2021, the Schools share under the Revenue Sharing Formula grows 3.0%. As such, the City's support of schools under the formula increases from \$212.34 million in FY 2020 to \$218.66 million next year.

Employee Compensation – the budget includes provisions for a 2.25% general wage increase for City employees. This increase will require revenue totaling nearly \$6.0 million, including \$5.5 million supported by the General Fund. For FY 2021, we have also continued the Performance Pay Plan that rewards the best performers in each department with an additional pay raise ranging between \$500 and \$1,500. The Performance Pay Plan adds an additional \$700,000 to employee compensation.

Retirement Costs – every two years, an independent actuarial study is conducted to determine how much the City must pay into the retirement plan. The actuaries compare the value of the plan assets with the expected future payments to employees when they retire in order to determine how much we need to pay into plan each year. For the current biennium, Chesapeake's retirement rate increases from 14.26% of applicable wages to 15.64%. That represents a 9.7% increase in the cost of retirement benefits and increases the City budget by \$2.6 million.

Employee Healthcare – the cost to provided healthcare to City employees and their families continues to climb. The most recent renewal resulted in a 10% increase in healthcare; an increase that was shared with employees. For the upcoming budget, we have assumed healthcare costs would continue to climb at 10% annually and that

we would share the increased costs with employees. The additional cost to increase the City subsidy is \$3.7 million. It is important to note that health care costs represent 25% of employees' total compensation making it second only to wages as a share of the City operating budget.

Curbside Recycling – Earlier this year, Council approved an extension of our curbside recycling program, and we have included capacity in the FY20 budget to maintain that program. The program, including the recycling of green (yard) waste, increases from \$2.7 million during FY 2020 to \$4.4 million next year (an increase of 61%).

Expanded Services – while the majority of the budget is dedicated to maintaining existing services, there are a few proposed service expansions that I would like to highlight. First, of great importance to our community and our employees, is enhanced safety measures at the City Hall complex. Several months ago, the Police Department began assigning additional officers to patrol City Hall and surrounding buildings during business hours. This has been accomplished by paying overtime to officers that would otherwise be off-duty. The police presence is a valuable resource that contributes to the safety of our employees and visitors. While this budget results in additional part time positions, the expenditure is being offset by reductions in overtime. Second, is an addition of three positions for the satellite garage. We will soon open the new facility and, while this budget does not fully staff the garage, these positions will begin to provide the services intended by Council when authorizing the facility construction. Finally, I am proposing two new positions in the Department of Parks, Recreation, and Tourism to focus on historic preservation and enhanced historic tourism services and programming. This service will add value to the community through preservation of our historic resources and capitalizing on the tourism benefits of those resources. **It is important to note that all of these positions are more than offset by identified savings within each of the three agencies.**

Meeting Expectations within Existing Resources

As has already been mentioned, the cost to meet existing obligations and expectations is climbing faster than General Fund revenue. In order to address this imbalance, we recommend using funds that are available in the Greenbrier TIF Fund. While we are crediting over \$11.6 million to the Greenbrier TIF each year, TIF obligations are approximately \$2.5 million annually. It is essential that we use surplus funds to meet ongoing service costs, particularly as the ongoing development within the Greenbrier TIF area will continue to require City services at a commensurate rate. Since TIF revenue is derived from real estate taxes, it is consistent with our past practices that the City share the surpluses with schools. As such, for FY 2021, I recommend that Council declare a surplus of \$5.5 million (an increase of \$3.0 million above the FY 2020 level) and share that amount with schools via a credit to the School Lockbox for capital projects. This would fully fund the schools budget request and begin to add capacity to address future schools capital needs.

Looking Forward

In developing the annual operating budget, we carefully considered the long-term impacts of current budget decisions. As was noted above, each department provided a three-year budget that addressed not only their immediate requirements, but also strategic plans and requirements beyond FY 2021. Each year we will also review proposals that have merit and that are consistent with Council's long-range plans. Proposals that meet these criteria, and which are sustainable, will be recommended for funding.

We have included the three-year spending plan in Section B of the budget document with the underlying assumptions immediately following. We anticipate General Fund revenue will grow from \$603 million in FY 2020 to \$643 million in FY 2023 (6.6% over three years). General Fund spending is expected to rise from \$325 million in FY 2020 to \$340.9 million in FY 2023 (4.9% over three years). During the same period, operating transfers to Chesapeake Public Schools under the revenue sharing formula are projected to grow from \$213.6 million to \$234.3 million (9.7% over three years). Since City and School costs are rising faster than revenue, we must remain vigilant with spending plans so that we avoid more difficult and disruptive options during economic downturns.

Conclusion

This budget balances existing revenues and other resources with overall service demands. As such, we recommend holding the real estate tax rate at \$1.04. However, given the current pandemic, we will need to carefully monitor the situation and will likely propose modifications (some perhaps significant) prior to budget adoption. The FY 2021 Proposed Operating Budget honors our commitment to Chesapeake Public Schools while also addressing retention, recruitment, and healthcare costs of City employees. Finally, it should be noted that we have left some unencumbered capacity to address emerging issues that are not in the proposed budget, but that may require more immediate attention.

In the coming weeks we will solicit public input and schedule work sessions for the Council to review this proposed budget with a focus on sustainability. The City's staff remains committed to providing quality public services, while recommending a prudent spending plan that protects the City's financial position. We also propose strategically adding resources in areas that have been underfunded or face new demands.

I am confident that the strategies recommended in this proposed budget meet expectations for quality levels of community services while also sustaining the City's strong financial position. I look forward to working with the entire City Council in the coming weeks as you review this proposal and adopt a budget plan that meets the current and future needs of Chesapeake citizens.

Sincerely,



Christopher M. Price
City Manager