

March 26, 2019

The Honorable Mayor Rick W. West and Members of City Council
City of Chesapeake, Virginia

Dear Mayor West and Members of City Council:

Today, I am pleased to submit the Proposed Operating Budget for Fiscal Year 2020. This is the seventh budget I have submitted to you since arriving in 2013. In that time we have seen the City's annual revenue grow 23% from \$910 million in FY 2014 to an estimated \$1.12 billion next year. The continued and sustained growth we have experienced is proof that Chesapeake's economy is vibrant and expanding. Construction activity has been at a moderate, but sustained level during the recovery that followed the 2007 recession. Economic growth has provided a growing tax base sufficient to support an increasing population, expanding community demands and rising costs of city government. While we still have numerous challenges, Chesapeake is well positioned for continued growth in the years ahead.

For FY 2020, we are proposing an Operating Budget of \$1.1 billion supported entirely from projected revenue. We estimate overall revenues will grow 4.3% next year led by a 4.4% increase in real estate taxes and a 5.7% increase in personal property taxes. New construction and growth in assessments are increasing real estate tax collections. We project other local taxes will grow by 3.4% as consumer spending and business activities continue to expand. Finally, we estimate growth in State funding of 4.0%, including a 4.5% increase in State support of schools.

In developing the budget, I have required department leaders to estimate their budgetary requirements not only for the upcoming year, but for three years into the future. It is essential that we estimate the impact of current budget decisions on future spending before the City commits to programmatic expansions. This is especially important in today's expanding but volatile economy; with many local economists forecasting a significant downturn in the coming years. My recommendation is to limit service expansions and commitments that would need to be reversed if revenue growth were to falter.

The proposed Operating Budget for FY 2020 reflects an increase in spending of \$48.2 million or 4.5% of the FY 2019 budget. This budget proposal is balanced and it provides resources necessary to:

- Improve wages of City and School employees;
- Address the most urgent funding requirements for Chesapeake Public Schools;

- Address the rising cost of employee healthcare; and
- Address emerging issues facing the City.

I have proposed a balanced and sustainable spending plan that addresses City priorities. However, I am not recommending that we spend all available resources. As with previous years, it is more important that we stay on a sustainable path that does not cause disruption when we encounter economic storms. During periods of relative prosperity, it is important that we maintain healthy reserves for downturns that will inevitably occur in the future. It is also important that we avoid initiatives that will require ever increasing resources in future years. Our public schools continue to face challenges in reconciling State funding levels with their growing needs and three-year projections continue to indicate that overall City spending is growing more rapidly than our revenues. For this reason, we have been careful to only recommend expansions that are essential or that will produce savings in the future.

Council's Guiding Principles

The FY 2020 Operating Budget was developed with guidance from City Council, including the following principles that have served as a foundation of Chesapeake budgets for the past decade:

- 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.

This budget proposal is consistent with the Council's guiding principles. The proposed budget assumes that the real estate tax rate will remain constant, currently \$1.05 per \$100 of assessed value (including the Mosquito Control tax). We are also recommending that all other existing tax rates remain in effect for FY 2020. While fee schedules have not been determined, any fee increases will be modest and only reflect rising service costs. Finally, we do not propose changes to existing plans for utility service during FY 2020. Water and sewer service rates are scheduled to rise by 2.0% in January 2020, as previously approved by the Council and there are no fee changes proposed for stormwater or solid waste collection.

Budget Drivers

The inflation rate remains relatively low and cost increases have been moderate but appear to be rising. While the Consumer Price Index rose an average of 1.5% annually over the last five fiscal years, inflation rose to 2.9% in FY 2018. It then slowed during the second half of calendar year 2018. At December 2018, the index was 2.4% above the previous December. It appears that federal tax and spending policies have pushed inflation up somewhat, but price growth remains stable.

While overall inflation rates are low, healthcare costs continue to climb at a very high pace. The combination of employee utilization of healthcare related to an aging population, new medical technologies, and rapidly growing pharmacy costs continues to challenge city leaders. We anticipate healthcare costs will climb by 9% annually.

Most economists consider the country at or above full-employment. The unemployment rate at the national level is below 4% and the regional rate is even lower (3.18% at January 2019). While low unemployment is good news for the economy, it also means employers have difficulty finding new workers and retaining existing ones. Typically, low unemployment levels puts pressure on employers to pay more. Because the city is a significant employer, it faces the same pressures as it seeks to retain employees and fill vacant positions. For this reason, it is especially important that we address employee compensation during FY 2020.

Major issues addressed in this budget:

- **Staffing Requirements:** The Budget Review Committee evaluated requests for 72 new positions from departments throughout the City. After a thorough inquiry and analysis of departmental requests, we recommend the funding of 30.75 full-time equivalent positions (FTE). Most of the new positions are funded either directly or indirectly from the General Fund. Seven positions are funded through Public Utilities and one part-time position is added to the Stormwater Fund. A complete listing of the new positions costing \$1.47 million annually appears in Section B of the budget document.
- **Employee Compensation:** The FY 2020 Operating Budget includes a 3.25% general wage increase along with provisions for superior performance awards and market adjustments for select employee classifications whose pay is below market comparables. All pay adjustments will be effective in early July 2019. The total cost of all pay enhancements planned for FY 2020 is \$8.9 million. A more complete description of changes in employee compensation follows the new position listing in the summary section.
- **Employee Healthcare:** The City has made numerous changes to the employee health plan in an effort to reduce growth in costs. However, costs continue to grow faster than funding of the plan. Starting February 2018, we separated the management of pharmacy benefits in an effort to reduce costs by \$1.7 million annually. Preliminary information indicates actual savings were substantial, but smaller than initially expected. We have increased projected growth in healthcare costs to 9.0% annually in the proposed budget and in longer-range projections (previous projections assumed 7.0%). Because of changes in employee elections, the budgeted increase going into FY 2020 is only 4.4% greater (\$1.67 million) than the FY 2019 budget.
- **Solid Waste Disposal:** Starting January 2018, the tipping fee paid to the SPSA, the regional waste disposal authority, dropped from \$125 per ton to \$65. The rate is to drop further starting July 2019. The existing rate saves Chesapeake nearly \$5.7 million annually compared to the rate paid before last year.

While the reduction in solid waste costs has been a tremendous relief to the city, the curbside recycling program is a challenge. Changes in the market for recyclables have severely impacted the city's contractor. The current contract expires in November 2019 and we anticipate a large increase in the cost to continue the program as it currently operates. It is also likely a new contract would result in less recyclables at a substantially larger cost (currently \$2.6 million per year). We have not recommended an increase in the budget as the current program is not sustainable. Instead we recommend using the existing budget to restructure the program.

Looking Forward

In developing the annual operating budget, we carefully considered the long-term impacts of current budget decisions. Each department provided a three-year budget that addressed not only their immediate requirements, but also strategic plans and requirements beyond FY 2020. 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 \$580 million in FY 2019 to \$636 million in FY 2022 (9.7% over three years). General Fund spending is expected to rise from \$311 million in FY 2019 to \$342 million in FY 2022 (9.8% over three years). During the same period, operating transfers to Chesapeake Public Schools under the revenue sharing formula are projected to grow from \$205 million to \$230 million (12.2% 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.

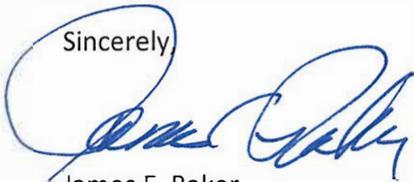
Conclusion

This spending plan balances existing revenue and other resources with overall service demands. As such, no increase in property taxes is proposed. The FY 2020 Proposed Operating Budget honors our commitment to Chesapeake Public Schools while also addressing retention, recruitment, and healthcare costs of City employees.

In the coming weeks we will 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 most citizen 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,



James E. Baker
City Manager