

March 28, 2017

The Honorable Mayor Alan P. Krasnoff and Members of City Council
City of Chesapeake, Virginia

Dear Mayor Krasnoff and Members of City Council:

Today, I am pleased to submit the Proposed Operating Budget for Fiscal Year 2018. General fund revenue is projected to be 2.8% above the FY 2017 budget, with real property values (reassessment plus new construction) increasing by 4.6%. While the local economy continues to underperform the nation as a whole (due in part to the impacts of federal sequestration), the city's revenue trends are showing definite improvement. We remain confident about the future and expect current growth rates will be sustained over the next three to five years.

For FY 2018, we propose a spending plan that totals \$1.013 billion for the Operating Budget. This represents an increase of \$37.8 million or 3.9% of the FY 2017 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;
- Reduce the backlog of individuals requiring crisis response and prevention services through Chesapeake Integrated Behavioral Healthcare;
- Provide sufficient staff for a major expansion of the city jail (192 bed annex);
- Begin transition to full-day kindergarten at all elementary/primary schools; and
- Improve emergency response and dispatch (E911) by adding staff in the Police Department.

Council's Guiding Principles

The FY 2018 Operating Budget was developed with guidance from City Council, including the following principles that have served as a foundation of Chesapeake budgets for the last several years:

- 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 efficiencies 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). While no *new* fees are required for this budget proposal, the budget includes an increase in water and sewer utility rates of 4.9%. The fifth and final scheduled rate increase approved in 2013 will take place July 2017. This rate increase is necessary to maintain a stable enterprise fund and to allow for system improvements required by emerging environmental regulations. We also anticipate recommending smaller annual utility rate increases starting in July 2018.

No other changes are proposed in tax rates or fees for services.

Budget Drivers

Fortunately, we are in a period of relatively low inflation and most cost increases have been moderate (during the last five years, the Consumer Price Index rose an average of 1.3% annually). Prices in the more volatile energy sector climbed during calendar year 2016 but are still lower than four years ago. We expect energy prices will continue rising during FY 2018 as the general economy improves, but that prices will remain below the 2014 levels. Healthcare costs remain an exception to the overall low inflation. 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.

Other major changes in government costs proposed in this budget:

- **Staffing Requirements:** The Budget Review Committee evaluated requests for 108 new positions from departments throughout the City. After a thorough inquiry and analysis of departmental requests, we recommend the funding of 61.73 full-time equivalent positions (FTE). Practically all of the new positions are funded with new programmatic revenue, by reducing other expenditures, or from enterprise revenue. The newly funded positions:
 - ✓ Ensure effective use of scarce resources by lowering overtime and temporary service costs;
 - ✓ Address staffing requirements at the new jail annex scheduled to open in March 2018;
 - ✓ Address new service demands that are funded with new revenue; and/or
 - ✓ Improve the City's response to citizen service demands.

Most of the new positions are needed for the Sheriff (11.0 FTE), the Police Department (10.63 FTE), the Water and Sewer Utility Fund (16.75 FTE), and for Chesapeake Integrated Behavioral Healthcare (16.00 FTE). The utility fund is supported exclusively with user fees and the added

positions in CIBH are related to a statewide effort to improve the delivery of behavioral health services. FY 2018 also represents the second year of a three year planned program to increase the authorized number of City Police Officers. Last year, five officer positions were added to the budget; we are recommending two added positions for FY 2018. A listing of the new positions costing \$4.65 million appears in Section B of the budget document.

- **Employee Compensation:** The FY 2018 operating budget includes a 2.5% general wage increase effective in July 2017 for all eligible employees. It also includes a provision for performance recognition and market adjustments for select employee classifications whose pay is significantly below neighboring municipalities. Market adjustments ensure we are able to attract and retain qualified personnel. Both the performance recognitions and the market adjustments will be effective in October 2017. The total cost of employee pay enhancements planned for FY 2018 is \$6.8 million. A more complete description of changes in employee compensation follows the new position listing in the summary section.
- **Healthcare:** Even as the City has taken steps to reduce the growth in employee health care costs, medical claims for the most recent contract period were significantly above estimates. While retiree utilization of health care outpaces that of active employees, increased claims by all participants resulted in an 18.5% increase in the renewal estimates for the plan year beginning January 2017. In order to hold employee premium increases to 8%, the City increased its funding of the program by 21% and continued a three-pronged approach to stabilize future costs. First, it moved from a fully-insured plan to a self-insured plan starting January 2016. While the City assumes greater risk under the new funding model, we believe the self-insurance plan will provide new opportunities that benefit all participants and help to stabilize costs in the long run. The second strategy was to strengthen the employee wellness program by providing greater incentives for employees to get full physicals from their physicians. Finally, we are encouraging more active participation by members through the addition of options involving a new high-deductible health plan.
- **Payroll Efficiencies:** Employees are paid in two payroll cycles: weekly and semi-monthly. Weekly employees are paid in arrears, generally seven days after the last day of their pay cycle. Semi-monthly employees are paid current rather than in arrears (on the 15th and 30th day of the month) causing significant rework and added procedures in order to avoid overpaying employees who are absent from work. In 2014 the City Auditor recommended that we evaluate the conversion of semi-monthly personnel to arrears pay and implementation of a bi-weekly payroll schedule. The FY 2017 budget included a \$3.6 million one-time provision to implement arrears pay for all employees. While we continue to study implementation of a weekly or bi-weekly payroll schedule, no provision for further implementation of payroll changes is included in the FY 2018 budget.

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 2018. 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 a three-year spending plan on page B-15 of the budget document with underlying assumptions immediately following. We anticipate City revenue will grow from \$729 million in FY 2017 to \$783 million in FY 2020 (7.4% over three years). City spending, including transfers to the School Board, are expected to rise from \$696 million in FY 2017 to \$775 million in FY 2020 (11.4% over three years). While costs are rising faster than projected revenue, we are confident that future revenue growth will be adequate to address current and foreseeable service demands.

Conclusion

This spending plan balances existing revenue and other resources with overall service demands. No changes are proposed in general tax rates and only modest fee increases are proposed. The FY 2018 Proposed Operating Budget honors our commitment to Chesapeake Public Schools while also addressing retention, recruitment, and health care costs of City employees.

In the coming weeks we will schedule work sessions for Council to review this proposed budget in light of 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