

March 27, 2018

The Honorable Mayor Richard 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 2019. General Fund revenue is projected to be 3.6% above the FY 2018 budget, with real property values (reassessment plus new construction) increasing by 4.6%. This is a small improvement over the previous year and indicates the strength of the economic conditions in the City. However, we are concerned that the Hampton Roads regional economy continues to underperform both state and national trends. Both the region and Chesapeake remain heavily dependent on federal spending and we are uncertain how proposed investments in military readiness will affect the regional economy. For this reason, we project that City revenue will grow at modest rates over the next several years.

For FY 2019, we propose a spending plan that totals \$1.046 billion for the Operating Budget. This represents an increase of \$31.2 million or 3.1% of the FY 2018 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 address the City's priorities. However, I am not recommending that we spend all available resources. As we have discussed recently, it is more important that we stay on a sustainable plan 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 2019 Operating Budget was developed with guidance from City Council, including the following principles that have served as a foundation of Chesapeake budgets for much of 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 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). We also recommend that existing tax rates remain in effect for FY 2019. While fee schedules have not been determined, any fee increases will be modest and only reflect rising service costs. Finally, we do not propose increased fees during FY 2019 for water, sewer service, stormwater, or solid waste collection.

Budget Drivers

Fortunately, inflation remains low and most cost increases have been moderate but appear to be rising. While the Consumer Price Index rose an average of 1.4% annually over the last five years, inflation during the last two years was 2.1%. We expect changes in federal tax and spending policies will increase inflationary pressures but are uncertain of the extent. Prices in the more volatile energy sector climbed nearly 17% since 2015 but are still 16% lower than in 2014. We expect energy prices will continue rising during FY 2019 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 65 new positions from departments throughout the City. After a thorough inquiry and analysis of departmental requests, we recommend the funding of 33.5 full-time equivalent positions (FTE). Approximately 57% of the cost of the new positions are funded with new programmatic revenue, by reducing other expenditures, or from enterprise revenue. The remaining portion (43%) is funded from general tax sources of the General Fund. 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 Spring 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 (4.6 FTE), Public Works (5.7 FTE), the Water and Sewer Utility Fund (7.0 FTE), and for Chesapeake Integrated Behavioral Healthcare (8.5 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. A listing of the new positions costing \$2.41 million appears in Section B of the budget document.

In the aftermath of the recession, the City reduced a number of positions and delayed adding others that were requested by departments. With continued growth and new demands, we have added 6.4 FTE positions to several administrative and support areas. The new positions include converting a part-time Budget Analyst to full-time status, adding a Business Application Analyst and part-time Office Assistant to Human Resources, a Security Manager to IT, a Library Manager for the Central Library, a Principal Planner in the Planning Department, and a Communications Coordinator in Public Communications. Each of these positions will expand departmental capacity to meet growing demands.

- **Employee Compensation:** The FY 2019 operating budget includes a 2.5% general wage increase effective in July 2018 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. The performance recognitions and market adjustments will be effective in October 2018. The total cost of all pay enhancements planned for FY 2019 is \$6.2 million. A more complete description of changes in employee compensation follows the new position listing in the summary section.
- **Employee Healthcare:** Even as the City has taken steps to reduce growth in employee health care costs, medical claims for the most recent contract period were significantly above estimates. Starting in February 2018, the management of pharmacy benefits was separated from other healthcare coverage. The new pharmacy benefits plan (PBP) is expected to save \$1.7 million during calendar year 2018. With the PBP in place, the cost of health benefits is estimated to increase approximately 7.0% in calendar year 2018. Without savings from the PBP, the increase would have been 11%.

In developing the budget, we have projected an 8.5% annual growth in the cost of employee healthcare. If healthcare costs grow more than we have estimated, it may be necessary to: (1) recommend a mid-year increase in the budget for healthcare, (2) shift more costs to employees and retirees during the 2019 open enrollment, and/or (3) consider changes in plan design (benefits).

- **Solid Waste Disposal:** Starting in January, the tipping fee for waste accepted by SPSA, the regional waste disposal authority, dropped from \$125 per ton to \$65. That saves Chesapeake nearly \$5.5 million annually. Waste disposal costs are expected to be at similar levels with modest adjustments for inflation for the foreseeable future.
- **Information Technology:** We recommend an 18.5% increase in the technology budget (\$2.4 million) in order to address a delay in migrating applications from the mainframe, address increase data security risks, and a significant increase in Microsoft licensing costs.

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 2019. 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 the underlying assumptions immediately following. We anticipate General Fund revenue will grow from \$559 million in FY 2018 to \$609 million in FY 2021 (9.0% over three years). General Fund spending, is expected to rise from \$296 million in FY 2018 to \$323 million in FY 2021 (9.2% over three years). During the same period, operating transfers to Chesapeake Public Schools under the revenue sharing formula is projected to grow from \$195 million to \$217 million (11.4% 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.

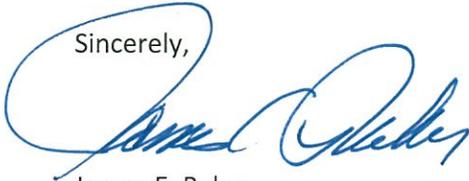
Conclusion

This spending plan balances existing revenue and other resources with overall service demands. As such, no increase in property taxes are proposed. The FY 2019 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 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