CITY OF NEWPORT NEWS

OFFICE OF THE CITY MANAGER

March 25, 2014

TO: The Honorable City Council

FROM: City Manager

SUBJECT: Recommended FY 2015 Operating Budget

I am transmitting for your consideration, the City's recommended operating budget for the fiscal year that begins July 1, 2014 and ends June 30, 2015.

This memorandum summarizes our proposed Fiscal Year 2014-2015 operating budget for the City of Newport News. This recommendation reconciles community needs and organizational necessities with continuing, significant financial constraints. The details of the Recommended Budget are necessarily complex, as are the needs of this community. While many important initiatives, priority judgments, and more nuanced recommendations are included in the budget, the factors shaping its main features are fairly straightforward.

Expenditure requirements are driven by six factors: a need to keep our salary structure competitive and by investing in our employees, to continue efforts to bring our pension system into sustainable balance, to restore funding for various operations that were reduced during the recession (paving, equipment, technology), to maintain funding for the Schools division, and to provide support to our Strategic Priorities.

<u>OVERVIEW</u>

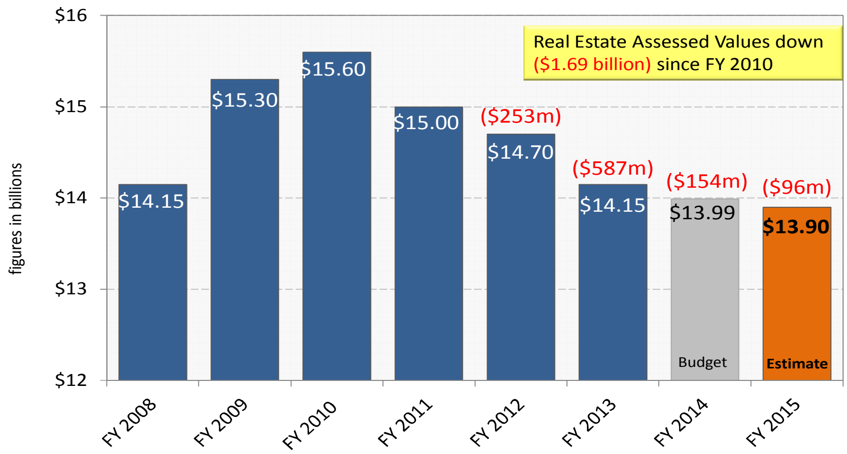
We are submitting to you a budget that addresses the community's needs on several differing levels. First, the proposed budget maintains the basic services that citizens expect of the City of Newport News. Essential expenditure increases were made to limit service reductions or to maintain contractual agreements at the same level in the upcoming year that we are presently receiving. Second, no public services will be eliminated, and we are able to increase infrastructure investments and equipment funding that was reduced during the recession (residential street paving, information technology equipment, and operational vehicles). Third, in the proposed budget we must fund a full year of the City's share of the Peninsula Regional Animal Shelter. In addition to the extent possible the Recommended Budget expands the investment in City Council Strategic Priorities.

The total recommended FY 2015 budget is $810,882,256, which is an increase of $28,395,095 or 3.6% higher than the adopted current fiscal year budget. This total budget amount includes the General Fund, Schools, Public Utilities, and all Special Revenue and Trust Funds. In two of our major funds, there are some notable changes. For the second consecutive fiscal year, it is anticipated that the School Fund will experience more in revenue from the Commonwealth for operations; that Fund will be higher in the upcoming fiscal year by over $9 million. In what appears to be an encouraging change from past experiences, Public Utilities (Waterworks) water demand is leveling within projections. With this change in demand, only a minor increase in the monthly service fee is required to continue the policy started in FY 2012 of moving that Fund's revenue base from being dependent on the volume of water used to fees that are fixed more to service delivery costs.

Of this total budget amount, the FY 2015 Recommended General Fund Operating Budget totals $446,649,000, which is an increase of $13,236,000 or 3.1% higher than the adopted FY 2014 Operating Budget. This increase allows us to meet contractual obligations, sustain services, and covers many mandated costs while meeting Pension commitments, providing an employee salary adjustment, and making significant strides in the necessary steps in addressing salary compression.

As you know, current Real Estate Taxes are generated from real estate values. Real estate property assessments, which are based on market values established for the 12-month period of January 1, 2013 to December 31, 2013 (calendar year 2013), are expected to decrease for the fifth consecutive fiscal year. While any decrease in property assessments is disappointing at this stage of the national economic recovery we feel that we have hit the bottom of these decreases. The chart below illustrates the change in values, with the anticipated Real Estate Levy on July 1, 2014 to be less than that of FY 2008.

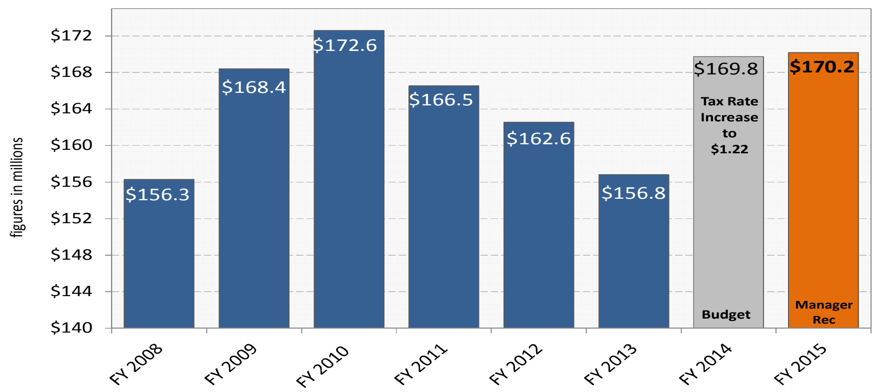
Recent History of Real Estate Assessment Values



While each individual property may see a unique assessment change determined by the specific property type, the FY 2015 Recommended Budget was based on an average assessment decrease of approximately (1%), with most residential property owners paying real estate taxes on a lower valued property than in FY 2014. To put this in the Real Estate Tax revenue perspective, this percentage decline in assessments equates to a $1.6 million loss from the City's single largest revenue stream just between FY 2014 and FY 2015 at the same tax rate. Commercial and Industrial properties will be fairly stable, with some areas of differing change, again based on property type.

However, at this time, even with a lower overall Real Estate Levy anticipated, we are projecting our Real Estate Tax collections to be level with the current fiscal year at $164.5 million by the close of the year in June 2015. This is due in part to projects that are occurring in the current fiscal year but are not fully been added to our levy, and anticipating certain other real estate growth over the next 16 months in various other retail and high volume residential projects.

The History of General Fund Real Estate Tax Revenue



As we are faced with another year of ongoing assessed value decline the City remains committed to the tax deferral program for our elderly and disabled citizens. Just a few short years ago, in FY 2012 under the tax abatement program, tax relief represented close to a $3 million loss in revenue to the City, exclusive of the impact of the loss of $475,000 in additional real estate revenue from the newly mandated tax relief for Disabled Veterans. Without a change to the tax abatement program, the City would lose substantial and increasing amounts of Real Estate Tax revenue over time. As a result of changing from tax abatement to tax deferral, our loss of revenue from the tax deferral program is anticipated to decline from $3.3 million in FY 2011 to $1.4 million in FY 2015. Over time, this revenue loss will be completely eliminated, while the substantial benefit through deferral is maintained for most impacted individuals. As the State-mandated tax relief for Disabled Veterans continues to become more widely used, the City's liability has increased. For FY 2015, this highly specific tax relief will increase by $150,000 to an anticipated $800,000.

As you know, the State's payment to localities declined for five consecutive years, not including overall under-reimbursement for State programs as has been the pattern for many years. During this time period, the City has lost a cumulative $7.9 million in direct State Aid to Localities. As the City absorbed these expenditures within its base budget, the State experienced surpluses in its operating budget. Recognizing the burden from continued State funding reductions, the FY 2014 State Adopted Budget "restored" State funding to select activities. In the State's terminology, restoration meant that an additional reduction to the localities planned in FY 2014 did not occur, and that State funding continue the reduced FY 2013 level. This "restoration" was again carried forward into the FY 2015 Governor's recommended budget. At this time, the General Assembly has not adopted a budget for the upcoming biennium, and we have not been able to determine the full impact that it will have on our operating budget. However, at this point we have seen some marginal changes, but not to the extent of prior fiscal year reductions.

Other General Fund revenues for FY 2015 have been estimated based on a continued relatively slow economic recovery, but with some optimism that the recovery will continue to expand in the coming fiscal year. Locally expanding generated Machinery and Tools and Personal Property Taxes revenues are showing moderate changes, with increases of $900,000 in each over the current fiscal year. Sales Tax revenue has been improving marginally monthly over the prior fiscal year, after recovering from the impact of federal sequestration and lack of a federal budget during the first quarter of FY 2014. The estimate remains on target for collections in the current year and includes projections for expanded revenue in the amount of $922,491 due in part to economic stability and expanded retail development in City Center. The same factors will apply to Meal Tax revenue as well, that is estimated to increase by $1.1 million.

In order not to be overly reliant on the performance of real estate tax revenue and the other consumer taxes, an adjustment in local Lodging Tax is being proposed. This particular rate is recommended for increase as it is a specific tax that is based on a personal choice and a majority of it is paid by non-Newport News residents. For the Lodging Tax, it is recommended that the rate remain level with the current rate of 8.0%. In addition a flat $1 per day charge to be imposed on the booked room is recommended, with estimated new revenue of $800,000. The revenue generated from this tax is collected by the hospitality establishment and is passed through to the City, with no economic impact on the individual vendor. This is the sole General Fund tax rate increase that is proposed to support the upcoming fiscal year operations. As a reminder, we are only one of three localities in the greater Hampton Roads area that does not impose this per diem fee.

For the previous five years, due to the impact of falling revenue sources and proportionate expenditure reductions, the General Fund Operating Budget declined significantly. We cut costs and operations, eliminated services, reduced and postponed our fundamental infrastructure needs, and most recently, increased the real estate tax rate. We still must manage daily operations of public safety and corrections, make contributions to public education and essential public works operations, pay outstanding debt obligations, provide the human services safety net programs, as well as offer quality-of-life options to our citizens. More importantly we must move forward on restoring our infrastructure investment and our commitment to our employees. Yet our revenue stream is still insufficient in the recovering economy to meet all these issues. I am proposing using the projected surplus from the current fiscal year, in addition to an unanticipated refund, to help meet the upcoming fiscal year gap in revenue and expenses. For FY 2015, $3.3 million will be used from General Fund Balance as a revenue source. This use is not anticipated to have any detriment on our ability to meet extraordinary emergencies, and will be used to offset the increased cost of the higher Cash Capital expense planned in the FY 2015 Adopted Capital Improvements Plan (CIP). This use of Fund Balance falls within our adopted Debt and Financial Management Policies.

EXPENDITURE CHANGES

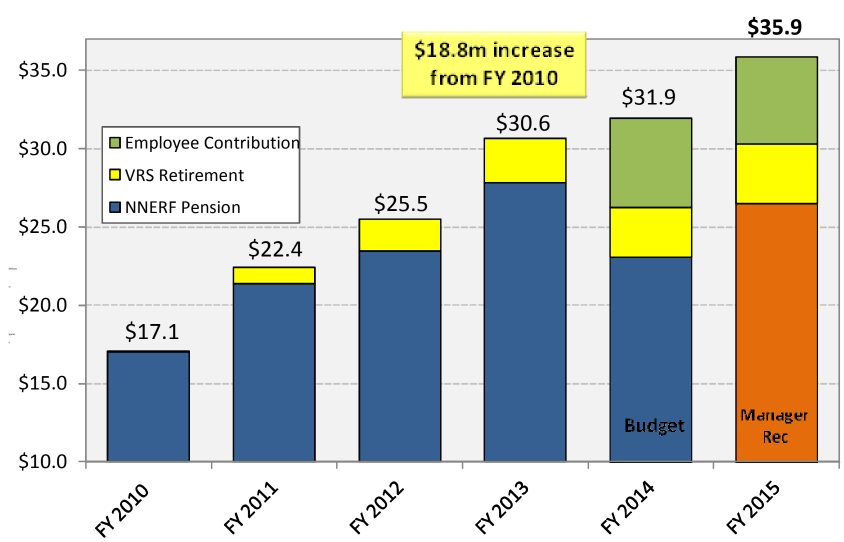
Early in the budget development process, it was clear that we would be affected by yet another year of potentially lower revenue streams. With this in mind, I instructed Department Directors to review all of their departmental operations and provide intelligent, practical, and sustainable budgets based on 95 percent of the revenue they had this year. They needed to focus on core functions, increase efficiency by reducing or eliminating non-essential operations, and/or reorganize staffing to accommodate the highest priority of those core services. We also needed to review if past reductions or program changes created an unfavorable or unanticipated result, and thereby hindered our ability to effectively operate. In some cases to achieve this magnitude of cuts there would have to be sustained reductions and program eliminations that could only be categorized as very significant. Given the several years of cost cutting, many of the significant cuts that were offered and reviewed involved curtailing services that I believe City Council and citizens would oppose. As you know, since FY 2009, operational expenses have been reduced substantially. Reductions and other changes proposed for FY 2015 are summarized in the Recommended Budget document under the blue tab labeled *Expenditures*.

There are six general areas where this recommended budget reflects focused spending or funding for specific initiatives. These areas include pension contributions, health care premiums, the City's contribution to the School Division, employee salary adjustment and development, an enhancement, where possible, of basic operational funding (paving, Cash Capital contribution, vehicle and technology replacement equipment), and funding for the Strategic Priorities.

Pension Contributions

We are committed to the eight-year plan to incrementally increase the City's contribution to the Annual Required Contribution (ARC) to the Pension Fund. FY 2015 will be the sixth year in this process. This is a fundamental expense of our operating budget; the recommended budget brings the ARC up to 82% from 73%. This step brings the annual contribution to the pension system to $26.5 million City-wide, with the Schools Division support at $6.6 million, and $5.6 million in additional funding from the 5% salary contribution of all NNERF employees. All combined, the total funding from City and employee contributions in FY 2015 will be $38.7 million. This recommended amount is consistent with our plan to completely restore the actuarial soundness of our pension fund over time. The City Council adopted changes to the Pension system in October 2012 that lowered the overall ARC dollar requirement from $56 million to $41 million over the planned eight-year period.

History of City Pension Contributions City-wide



As a member of Virginia Retirement System (VRS), we fully fund the annual contribution for those employees hired or rehired after

March 1, 2010 or who elected to shift from the City's pension system. As more of our workforce participates in VRS, so grows our annual contribution. This fact increased the General Fund payment by $517,416 from $2.4 million to $2.9 million. The VRS actuarial assumptions for the upcoming fiscal year did not change, and remains at 9.13% of salary cost.

As yet another change in the VRS retirement system, any non-public service employee hired on or after January 1, 2014 will be enrolled in what the State is referring to as the 'hybrid plan'. This VRS retirement plan is different for the employee as it combines the features of a defined benefit plan (which pays a monthly retirement benefit based on age, total service credit and average final compensation) and a defined contribution plan (which provides a retirement benefit based on contributions and the investment performance of those contributions). While the VRS City contribution rate remains the same for the VRS hybrid plan at 9.13% of salary cost, it does come with an added expense to the City. Those employees in the VRS hybrid plan are to be covered by the Virginia Local Disability Program (VLDP), which provides for eligible non-work related disability benefits. This will be a new cost to the City; in the General Fund the cost is $38,203 and $55,965 city wide. As a separate State requirement, we must participate in a Line of Duty Act program that provides benefits to first responders who die or become disabled in the line of duty. The City has made the decision in FY 2013 to be self-insured for this expense. In FY 2015, we will be establishing this cost as a separate special revenue fund, with a full-funded liability, supported by an on-going contribution from the General Fund of $250,000 for any claims during the year.

Health Care Costs

Health care costs continue to rise, with a 5% increase anticipated in FY 2015 beginning in December 2014. The annual increase is generally based on the prior-year claims and services provided to our employees. The resulting impact to the General Fund is a health care cost increase approaching $1.1 million, with an additional cost increase of over $249,000 spread across the other operating funds in FY 2015. This particular benefit continues to be an important factor as part of our overall compensation package, and it remains a strong recruiting tool and acts as additional leverage for soliciting qualified candidates when all other aspects of employment (e.g., VRS retirement options) are equal between the Hampton Roads localities.

While a critical element for employee compensation, increases in health insurance premiums have unfortunately become a large portion of the demands on the annual budget for the City. For FY 2015, Health Insurance premiums now represent 4% of the total General Fund. Careful plan management and lower experience costs have kept the premium increase responsibility low, but these two aspects have their limits and will only contain costs but so far. We are engaged in a multi-pronged approach to attempt to curb the growth in this annual expense. In FY 2014, as a first step to reducing long-term health care costs, we changed the traditional premium rate payment from the ratio of 75% City/25% employee contribution toward the total premium cost, to a set dollar value the City would contribute during the fiscal year. The City now offers three choices (instead of one) for Health Insurance policies: the traditional Preferred Provider Organization (PPO) plan, a HMO-Point of Service plan, and a high deductible plan. With each plan option, the individual is able to choose the coverage that best suits his or her needs, while the City and the employee both are managing their health care dollars in less expensive and less robust plans, and thereby encouraging employees to take a more active role in reducing their annual costs over time. To approach the long-term overall health care costs, the City began establishing a formal process of a defined Wellness Program with initial funding for this program continued in the Recommended Budget at $100,000. We will be further ramping up the Wellness program this year with the initiation of health risk assessments offer for all employees.

Fuel Prices

Fluctuating fuel costs make it difficult to determine a year-long average of per-gallon costs. Vehicle fuel is an important part of our operations, supporting public safety functions, public works activities, and human services programs, among others. Our annual consumption for many years remained stable at nearly 1.2 million gallons; however, it is now hovering at the 1.1 million gallon level. For the current fiscal year, costs are declining and have remained steadier than were originally projected for the fiscal year. The FY 2015 Recommended Budget assumes an average fuel purchase price of $3.20 per gallon, falling from the FY 2014 budgeted per gallon rate of $3.25. The resulting impact to the General Fund is a fuel cost decrease of ($167,410). This remains a sensitive expense and if fuel prices trend upward, we may need to change the rate forecast for fuel closer to the final budget reconciliation for FY 2015.

Contribution to Schools

Local support for public education is a critical indicator of the value the community places on education. Beyond that, our investment is an investment in our future and a critical piece of our economic development program. I am recommending a contribution of $115,300,000, which provides level funding with the current fiscal year. This is a recommendation based on my conversation with the Schools Superintendent on their needs for this coming year. This amount includes $12.3 million in City funding for Schools debt service.

The City increased funding to Newport News Public Schools (NNPS) for the past four fiscal years, signaling our commitment to public education. In a time when the State made massive reductions in its support to Schools (from $194.8 million in FY 2009 to a low of $158.4 million in FY 2012), Schools too have been faced with higher pension contributions, funding the State-proposed teacher salary adjustment, and achieving the State-mandated 5% employee contribution to VRS over a five-year period. The State's FY 2014 budget restored funding from the Commonwealth back up to the $163.8 million level. With the Governor's proposed FY 2015 Budget, the increase in State revenue is again included with additional funding of nearly $9.1 million. With the influx of State funding and the City's contribution, Schools will be able to hire 15 new teacher positions to address increased enrollment and to lessen the impact of the other pressures on the NNPS budget. From a broader City perspective, this level contribution to Schools aids in teacher recruitment and retention by assisting NNPS' proposed salary increase.

Employee Compensation, Investment in Employee Development

The recommended operating budget includes funding for an average 3% salary adjustment for eligible City employees, effective July 1, 2014. This salary increase will be merit based. We are fully committed to compensation based on performance. While we have outstanding employees and most a totally committed to the City, not everyone performs at the same level. We will be rewarding those that are outstanding performers. The cost of this salary adjustment in the General Fund is $3.8 million, for a total of $4.8 million City-wide.

As the City weathered the recession, it came at the cost of employee compensation. The combination of the years where no salary increases were given coupled with only across-the-board general wage adjustments have caused compression in salaries in various job grades and types throughout the City. In other words, due to the nature of salary adjustments over the past fiscal years, many of our employees are clustered around certain pay levels, which do not necessarily recognize experience, time in grade, and other contributing factors to differentiate salary compensation. To address this issue requires both time and resources. We are committing to a multi-year, phased process to review and correct our pay structure. As a first step, beginning in FY 2015, we have committed $950,000 to concentrate on the more serious areas of salary equity, with the view to having additional amounts required in the next fiscal years to resolve the issue.

A frequent target for reduction during lean financial times is another form of employee investment; training and development. In an effort to fund the most essential expenses and preserve employee benefits and positions, our training and education/employee development programs have suffered deep reductions city-wide over the past several years. Our employees are our greatest assets, and their continual advancement in their fields of expertise, as well as their personal growth, adds to the overall improvement of the City through exposure to diverse concepts and other business practices. As a step in restoring training and development funds, we are increasing funding in several areas: Internal Training and Development by $20,000 (recommended at $100,000), Tuition Assistance reimbursement by $100,000 (recommended at $150,000), Service Awards by $50,000 (recommended at $80,000), and city-wide training by over $53,000 in specialized areas. The total increased investment is only slightly more than $223,000, which is a very small percentage of our overall budget. This is one portion of the operating budget that will we need to focus on increasing as the availability of funds grows over the next fiscal years.

<u>Full-Year and Maintaining Funding, New Initiatives</u>

When the new 29,000+ square-foot regional animal shelter is completed in early summer, the City and three other localities will transition to this facility. The localities' shares of operations are Newport News: 47.21%, Hampton 35.86%, Poquoson 3.19%, and York County 13.77%. Estimated revenue from adoption fees, spay/neuter charges, and micro-chipping would go to offsetting the localities' costs for operations and debt service. The City's full year portion of the new Peninsula Regional Animal Shelter operating costs is $474,008, with the City's share of debt service at $295,103, for a combined cost of $767,110. This is an increase of $107,193. This cost is offset by the elimination of the use the SPCA sheltering facilities on a month-to-month basis ($236,999).

The Tourism Zone Benefit of $1,104,050 is based on a State program that allows for new businesses in the City's designated Tourism Zones to receive back, under specific conditions, a percentage of new sales, and food and beverage taxes generated during an agreed upon timeframe. Based on new businesses open or soon to be operating in these Zones, there is the potential for these funds to be reimbursed to the vendor. The offsetting new revenue created by these businesses is estimated in Sales, Admissions, and Meals Taxes for FY 2015.

Beginning in FY 2014, a component was created in the General Fund's Nondepartmental section to provide additional program funding for Strategic Priorities of the City. These are Economic Development and Redevelopment, Environmentally Sustainable Local Government Policies, Community Renewal and Maintenance, Fiscal Management and Efficient Operations, and Maximum Emphasis on Public Safety.

For the Economic Development priority, funding in FY 2015 in the amount of $250,000 is for the Cultural Attractions fund. The continuing purpose of these funds is to be a resource for both public and private museums and cultural centers to solicit the City for additional capital and operational support during the fiscal year.

The City has established a strong community maintenance initiative to promote neighborhood enhancements and revitalization Citywide. Through the most recent Community survey, citizens identified several codes compliance and enforcement issues as of primary importance. To that end, the base funding of $152,500 for our community maintenance efforts will be increased by an additional $103,000 for the demolition of abandoned and dilapidated housing that negatively impact the foundation of our neighborhoods. The increased funding will complement and support our existing efforts for grass cutting and litter removal for vacant and City-owned lots, expanded City landscaping and other beautification projects to improve our communities.

The reduction of violent gang and gang-related crime by youth and young adults in our City is a critical strategic priority for City Council and the community. The City Council approved $1,100,000 in FY 2014 for the City to develop and fund the U.S. Department of Justice Office of Juvenile Justice Delinquency Prevention Comprehensive Gang Model (OJJDP). The OJJDP Comprehensive Gang Model (Model) calls for five core strategies to be delivered through an integrated approach from a team of community agencies and organizations. The five strategies are: (1) community mobilization; (2) social intervention, including street outreach;

(3) provision of opportunities; (4) suppression; and (5) organizational change. The program is designed to reduce gang activity in targeted neighborhoods by integrating prevention, intervention, suppression, and reentry activities.

Consistent with the Model, the City Manager's Office established a Steering Committee in August 2013 to advise on the direction of the program and hired a Gang and Violence Prevention Coordinator in November 2013. A data assessment using gang intelligence is currently underway to prioritize the highest concentration of gang activity throughout the City. Once target areas are defined, street outreach workers will be hired and trained to engage gang members at the neighborhood level. Additionally, our strategic focus on gang prevention has resulted in four significant accomplishments.

Teamwork-Options-Pathways for Success Program
In September of 2013, the Department of Human Services received an $870,316 grant from OJJDP for the Teamwork-Options-Pathways for Success Program (TOP) to expand services to 300 youth over a three year period. TOP staff receives referrals for services from a wide variety of sources, conducts a risk assessment of youth, connects the child and family to services based on an individualized service plan, and monitors the progress of participants through individualized case management. Additionally, the Asset-Based Community Development (ABCD) approach will be used to empower youth to partner with adults to change community norms regarding violence. TOP operates at the South Morrison Family Education Center and serves youth at this location and other community-based sites.

Cal Ripken, Sr. Youth Development Park
The Boys & Girls Clubs of the Virginia Peninsula and the City of Newport News are building a state-of-the-art Youth Development Park to engage and develop "disadvantaged youth" through sports to change the cycle of violence in our community. City Council approved $300,000 in the FY 2015-2019 Capital Improvement Plan to leverage $1,200,000 in cash and in-kind contributions from The Boys & Girls Clubs. Construction of the Youth Development Park is expected to begin in the first quarter of FY 2015.

School Resource Officer Program
The Newport News Public School System and the Police are re-engineering the School Resource Officer Program. Focus group sessions with school and interested persons in the community and visits to observe School Resource Officers in their environment are underway. The revised program will be implemented this fall when the new school year begins.

Summer Youth Employment Program
The withdrawal of federally supported summer employment programs present challenges for youth who desire an opportunity to work. It is essential to target year-round youth employment initiatives to "disadvantaged youth" who are neither in school nor working. Therefore, development of a Summer Youth Employment Program is underway with the Greater Peninsula Workforce Development Consortium to serve approximately 100 disadvantaged youth and young adults between the ages of 16 to 24 who reside in the gang prevention target areas. The program will build on existing community partnerships and focus on financial literacy, remediation, job training, and self-sufficiency. The program will be implemented in the summer of this year.

As a result of our ability to remain focused on the challenges associated with gang violence in our community and move closer to full implementation of the OJJDP Model, An examination of programs such as the well regarded Seattle initiative shows a much higher level of funding that we have provided. I am recommending funding in the amount of $1,100,000 for the Youth and Gang Violence strategic initiative. We will realize full scale start-up of the Model in the first quarter of FY 2015 and based on the level of commitment in other large urban centers, I am concerned that our existing effort is underfunded.

The City made significant increased investment in three infrastructure areas in the current fiscal year: vehicle and heavy equipment fleet, information technology replacements, and street paving. For each of these areas, additional funding of $250,000, $950,000, and $1.5 million respectively was added in FY 2014. Because we are millions of dollars behind in our needs in these three areas, it is critical that we continue to invest in these areas. If we are ever to regain the appropriate replacement levels for these functions, where the cost of repairing and replacing does not exceed the value of the infrastructure, then we can only move forward with maintaining our level of funding and setting as a high priority increased funding in coming fiscal years.

To be able to fund the six focused expenditure areas, the FY 2015 recommended budget reflects reductions in other operational expenses, as well as the recommended rate and fee increases. There are few enhancements based on contractual circumstances or specific needs. As expected, in response to limited revenues, it was necessary to reduce service levels in some areas, as detailed below.

REDUCTIONS IN EXPENDITRUES

Eliminated Positions and Redirected Staffing

I am recommending a net reduction of 18 positions in the General Fund for FY 2015, with a net reduction of five other positions City-wide. Only three new positions are being added to the General Fund, with two new positions being added in the Stormwater Management and Wastewater Funds, at one position each. We have cut a net total of 179 positions City-wide over the past six years, with this reduction representing a 6.5% decrease of our workforce since the beginning of the recession.

The net number of position reductions identified above does not represent the full number of reduced positions over the past years. Some of the positions that have been eliminated have been repurposed to support efforts to improve efficiencies and/or to enhance our efforts and citizen responsiveness in critical areas. Examples of these are the staffing of the 311 Customer Contact Center and Denbigh Community Center in FY 2013, or the new positions at the Peninsula Regional Animal Shelter in FY 2014.

With the City being a service organization, it is clear that the majority of our operating costs are invested in our employees as salaries and fringe benefits. For FY 2015, the approach was to recognize the proper staffing levels for the services that we are able to accomplish and accomplish well, and to address the scope and scale of the Attrition Credit that has been established during the recessionary period. It is important bring the Attrition Credit to a realistic and manageable amount, while recognizing the appropriate staffing levels and not hindering overall departmental operations.

With the scale of eliminated positions in the past, and fewer employees performing essentially the same services as a workforce equal to 10 years ago, it is hard to find positions where the operational cost of a function is clearly no longer justifiable. It is only in those instances where we have recommended position eliminations. In the General Fund, the number of actual recommended filled positions is two (2) full-time employees. We believe these two individuals can be placed in other vacant positions. Sixteen (16) vacant positions will be eliminated, and vacant positions in the Human Services Department will be re-allocated to address more pressing community needs. In addition, one (1) position will be transferred to another operating fund, and three (3) new positions will be added. These three (3) new positions were considered essential to operations and therefore created by the elimination of two (2) other departmental vacancies. The net position change in the General Fund for FY 2015 is 18 fewer positions; the chart below details the proposed position changes.

General Fund Position Changes

Position Type	Filled	Vacant/ Transfer	New	Net Change
Front Line	0	-2	0	-2
Management	0	0	0	0
Professional	-1	-13	3	-11
Support/Clerical	-1	-4	0	-5
Total	**-2**	**-19**	**3**	**-18**

In the General Fund, of the three (3) positions being added, one (1) Deputy Clerk in the Circuit Court Clerk's Office is included to address the anticipated increased workload from the filling of the long vacant fifth Circuit Court judgeship in FY 2015. In the Human Services Department, there was a complex review of the needs of the Department as compared to the long-standing vacancies within the ranks. Due to the nature of the work, the extensive pre-employment background investigations that occur, and the very nature of a majority of the jobs, the vacancies in this particular department are problematic to fill. This does not indicate that the positions are not needed in the full operation and scope of services for the Department. However, the existing budget had an extremely high attrition credit of almost 13% so many of the positions could not have been filled within the existing budget. It must be acknowledged that even with the chronic vacancy levels in this Department, the work of the agency is still being accomplished. While the on-going effort to fill the standard vacancies continues, there have been more emergent needs of the community manifesting themselves. To be able to address these needs, the Department will eliminate a total of twelve (12) current vacancies, repurpose two of those vacancies into other functions, and reduce their overall departmental allotment by ten (10) positions and reduce the attrition credit to a more realistic 10%. There exists a critical need for additional staffing for the City's Housing Brokerage Team to address homeless issues. Currently lead by two full-time employees, by using two of the repurposed vacancies, this team's effort will be doubled. This is a critical effort as part of our focus on addressing homelessness, and will take on an added dimension as we begin to consistently address the aspects of our Hotel/Motel ordinance enforcement.

In the other operating funds, eight (8) vacant positions are being eliminated from the Parks Recreation Revolving Fund, primarily in the After-School program area, due to declining revenue from lower participation levels. One position is moving from the General Fund Engineering Department to the Stormwater Management Fund, as the duties primarily support those operations. One new position each is being added in the Stormwater Management Fund (one Senior Equipment Operator) and in the Wastewater Fund (one Generator Specialist) in support of the required work for the Regional Consent Order for sanitary sewer operations.

The functions of these eliminated allotments are no less important, and those duties have been added to the workload of remaining positions. The Attrition Credit that was first instituted in FY 2009 at $1 million is now over $7.7 million City-wide, with 73% (or $5.6 million) in the General Fund alone for FY 2015. (An Attrition Credit reduces a department's budget for salaries and fringe benefits based on an anticipated lag time between an employee termination and when a new employee is hired.) This budget was balanced due to these ongoing savings. However, as this Attrition Credit has grown over time to balance the budgets, it has created an unrealistic representation of the true costs of both staffing and operating the City. While there are some areas of our operations that an Attrition Credit can be used to reflect a representational hiring lag savings, in other areas it has grown to a larger percent of the operating budget that detracts from the accurate budgeting for programs. An example of this is in the Human Services Department. In FY 2014, the Attrition Credit was $2.4 million or 12.8% of salary and fringe benefits for the Department. With the elimination of ten vacant positions in that department, we were able to reduce the attrition credit by $500,000 to $1.9 million, which is a better representation of staffing. It our goal over the next fiscal year to continue this process of identifying vacancies, considering the repurposing or elimination of those slots, and budgeting for a more appropriate level of the hiring lag, which will all result in a more accurate overall operating budget.

As a reminder, the City has an established Reduction-In-Force (RIF) policy that allows for any employee who would lose their current position due to a reduction in force, to have the opportunity to apply for, and if qualified, be placed in vacant positions over other applicants.

OTHER OPERATING AREAS

Debt Service and Cash Capital

General Fund support for the City's Debt Service will be $37,263,308 in FY 2015. This includes payments for outstanding General Obligation Debt and a full-year expense for bonds issued in July 2011 and in September 2012. It also reflects the combined saving in debt service generated from three bond refunding of over $142 million from calendar year 2012. The Recommended Budget assumes one new General Obligation bond issuance during April/May of 2014. Depending on the amount of the bond issue, we are anticipating that even with upcoming capital projects in the order of magnitude of replacing an elementary school, the James River Fishing Pier replacement, and other large scale capital investments in the near future, through prudent cash flow management of bond proceeds we expect to be able to stretch our bond cash for more than one year from the issue date.

Cash Capital, a component of the City's adopted Capital Improvement Plan, is budgeted at $8,044,944 or $4.1 million more than the current fiscal year. The adopted FY 2015 – 2019 Capital Improvements Plan (CIP) anticipates using these Cash Capital funds, with an additional $3,925,000 from the Special Projects Fund to satisfy our Capital Financing and Debt Management Policies requirement of 20% cash capital funding. If all Cash Capital and Special Reserve Funds are used as adopted, a total of $11.9 million in projects will be cash funded, reaching a 29.4% level of cash capital funding. This will exceed our debt management policy limits by almost 10%. Cash Capital allows for current operating funds to be used to fund less expensive and more regular capital investments (e.g., roof and HVAC replacements, and capital equipment) to decrease reliance on bond cash for shorter term capital projects. By using $3 million of the General Fund Balance generated by anticipated additional surplus at FY 2014 year-end, we are able to close the gap on the funding needed to support the extensive and necessary list of cash capital projects in the FY 2015 CIP.

Community Support and Regional Organizations

The recommended funding for the thirty (30) Community Support agencies that are supported by the City is almost equal to the current fiscal year. Regional Organizations in which the City is a member or participant will receive level funding, with the exception of the combined funding for Thomas Nelson Community College (TNCC) and the TNCC Workforce Development Center. The FY 2015 combined Community Support and Regional Organizations amount is proposed at $9,546,031. This represents an increase in funding of $458,145, or 5.0% from FY 2014. At this point in time, the funding for maintaining our participation in the regional bus service is level, which will be discussed in detail in this section.

In the Recommended Budget, the Community Support and Regional Organizations recommendation maintains level funding for organizations that provide services to our citizens. For a majority of the Community Support agencies, annual reductions have been imposed since FY 2010. Many of these organizations augment City functions, and with additional reductions, we would stand the chance of losing services that we depend upon that are provided at a reduced cost.

For all Community Support agencies, funding will be equal to the FY 2014 level (which is essentially the FY 2012 level amount), with two exceptions. Funding in the amount of $55,000 for the Virginia Arts Festival (VAF) is recommended to be restored in FY 2015. City Council will recall that the FY 2014 Adopted Budget contained a reduction to this entity of $66,263. Based on an appeal from VAF for current fiscal year funding to support programming scheduled to occur in May 2014, City Council provided $43,000 from Community Support Contingency for this purpose. VAF's application for upcoming fiscal year demonstrated that VAF is expanding its programming events in Newport News in calendar year 2015, and it is reasonable to contribute to this effort. The Virginia Living Museum (VLM) was a beneficiary of support from the FY 2014 Cultural Attractions Fund in the amount of $400,000; we are recommending that this amount become part of VLM's funding for this coming year. The Museum holds a unique bond with the City. The facility is located on City property, is a cornerstone in the Schools SOL and other educational programming, and adds to the City's economic development with a multi-million dollar annual impact, while at the same time contributes to the City's quality of life of its citizens. After an initial review of their status, it is apparent that they have made significant investment on ensuring the best possible cash flow for their operations with a combination of grants, enhanced memberships and donations, and programming in this challenging economic environment. However, I believe there needs to be an in-depth review of their operations including a review of peer organizations and the role of local governments in funding these types of operations. The VLM has agreed to fully open their records for our review. As that occurs, we must take steps to ensure this entity continues to operate as the educational, cultural, and fiscal contributor that it has been to this City.

Regional Organizational Agencies are those where most of the City's contributions are based on a contractual agreement on a per capita support level. No other Regional Agencies offered reductions voluntarily. We are recommending level funding in FY 2015 for these agencies with the exceptions of Hampton Roads Planning District Commission (HRPDC) and Thomas Nelson Community College (as detailed above).

For the two transit agencies that support the Newport News citizen, level funding is recommended. The Williamsburg Area Transport Authority (WATA), that provides bus service between James City County and HRT's Lee Hall stop in Newport News, received an increased $10,000 in funding in the current fiscal year, and requested an additional 5% ($1,750) for FY 2015. However, the amount will be held to the FY 2014 level.

As in the past, HRT funding has been difficult to determine. At the outset of each year, HRT estimates its costs for the year and generates a budget for each of the participating localities. After year-end closing, HRT provides either a credit or an additional charge to each locality on a prorated basis based on the total cost of operations for the Agency as compared to the amount of the locality funding during the fiscal year. HRT submitted two separate requests to the City for FY 2015, one that did and one that did not contain the results of the Board approved fare increase. At the time of the final balancing of the Recommended Budget, we had not received the alternative, fare-enhanced request, which is lower than the amount represented in the *Community Support* section of the budget document. Both proposals represented an increase in operating costs and capital contributions, while maintaining the same level of service and routes that the City is currently engaged. The newest request for FY 2015 is for $5,887,923, which is $136,080 or 2.3% higher than our current amount of $5,751,843. This is despite the fare increase and the operation for the past year being accomplished with $300, 000 less than budgeted. At this point, I have recommended level funding for HRT in FY 2015. As you know, we have been actively engaging with HRT on the Cost Allocation Formula and how changes might be made to reflect a fully equitable position for Newport News. However, there is no assurance that we will avoid a costly year-end reconciliation expense from HRT.

The final amount recommended in Community Support and Regional Agencies is a Contingency amount of $60,000. While not specifically designated, this would allow for funding during the fiscal year for agency support as designated by City Council or the City Manager.

There were seven (7) agencies that solicited support in the amount of $1,903,582 that are currently not funded by the City. Some of these requests were for the restoration of funds eliminated in prior operating budgets and some were new grant requests. Restoration of funding of $55,000 for the Virginia Arts Festival is the only initiative from this group that is included in the Recommended Budget.

RATES AND FEE INCREASES

This balanced budget has been achieved with practical, sustainable expenditure reductions, and with limited rate and fee increases, and with planned savings from the current fiscal year. A Real Estate Tax rate increase is not recommended for FY 2015, by maximizing the stronger performing local revenues combined with expenses reductions. To recap, the Real Estate Tax rate will remain level with the current fiscal year at $1.22, and the Lodging Tax will remain level at 8.0% and institute a flat $1 per day Lodging Tax. We will be using $3.3 million of anticipated FY 2014 year-end surplus (that first reverts to General Fund Balance) to support our expanded Cash Capital efforts and the support our regional transportation costs.

For the User Fund fees, there are increases driven by mandates and this makes rate increases unavoidable. In the Wastewater and Stormwater Management Funds, these rate increases are driven primarily by the impact of the Consent Order and other environmental regulations. As detailed in the recent presentation to City Council, our requirement to reduce or eliminate sanitary sewer overflows and reduce the flow of pollutants into our waterways will require prompt studies and investment in system improvements, to begin to establish a cash capital method for projects in these funds, and to fully recognize the Indirect Cost payments to the General Fund. To address the Wastewater and Stormwater Funds needs, I am recommending that both rates be changed: for the Wastewater Fund, the rate would remain at $3.21 per hundred cubic feet used, with the addition of a new monthly service fee of $4 per month per connection, and for the Stormwater fee a change from $8.00 per ERU monthly to $9.75 monthly. In the Solid Waste Fund, the $0.50 per week increase on the container rate is necessary to cover the cost of operations. These proposed rate changes are shown below:

	FY 2014		FY 2015	
SOLID WASTE USER FEE		Per Week		**Per Week**
	Container Size	(each)	**Container Size**	**(each)**
	Medium	$5.00	**Medium**	**$5.40**
	Standard	$6.25	**Standard**	**$6.75**
STORMWATER MANAGEMENT FEE				
Rate/Equivalent Residential Unit/Month		$8.00		**$9.75**
Annual Rate per 1 ERU		$96.00		**$117.00**
SEWER USER FEE				
Rate/100 cubic feet/month		$3.21		$3.21
SEWER MONTHLY SERVICE FEE				
Rate/month		$0.00		**$4.00**

For Public Utilities, after many year of decreased in water demand consistent with other water utilities nationwide, our water consumption might be stabilizing in the current fiscal year. Following several years of an observed decrease in demand, this trend prompted City Council in FY 2012 to begin to shift the Water rate structure to collect more revenue from fixed service charges and less from volumetric use. This approach is consistent with the cost structure of the utility as cost of operations is predominantly fixed and nearly independent of volume of water sold. With the demand "right-sized" in FY 2014, the revenue from water sales seems to be level, and thereby requiring a less aggressive adjustment to the fixed service charges to customers in FY 2015. While the revenue is falling within the predicted ranges, Waterworks' expenses are impacted by the same cost drivers as the General Fund: pension increases, salary adjustment, higher health care costs, and the need to address aging infrastructure.

Therefore, some Water fees are recommended to be increased in FY 2015. The Water Rates themselves will be at the same level as they have been since FY 2013. For the Meter Service charge, based on the meter size of the customer, the average residential increase would be $1 per month. Waterworks continues to reduce operating expenses where possible, but these savings do not make up for lower water consumption. The proposed rates are shown below:

WATER RATES

Water Consumption Rates per one hundred cubic feet (HCF):

Fee	FY 2014	FY 2015
Single-Family Residential Bimonthly		
R1 Low Usage Lifeline (0 to 4 HCF)	$3.08/HCF	$3.08/HCF
R2 Normal Use (Greater than 4 to 50 HCF)	$3.55/HCF	$3.55/HCF
R3 Conservation Tier (Greater than 50 HCF)	$7.10/HCF	$7.10/HCF
Industrial Monthly		
I1 Tier 1 (0 to 40,000 HCF)	$3.55/HCF	$3.55/HCF
I2 Tier 2 (Greater than 40,000 HCF)	$3.08/HCF	$3.08/HCF
General (All Other Consumption)		
G - All other usage	$3.55/HCF	$3.55/HCF

Meter Size (Inches)	Monthly Charge	Bi-Monthly Charge	**Monthly Charge**	**Bi-Monthly Charge**
5/8	$14.67	$22.00	**$16.00**	**$24.00**
3/4	$17.60	$27.87	**$19.20**	**$30.40**
1	$23.47	$39.60	**$25.60**	**$43.20**
1 1/2	$38.13	$68.93	**$41.60**	**$75.20**
2	$57.20	$105.59	**$62.40**	**$115.20**
3	$121.73	$234.64	**$133.00**	**$256.00**
4	$176.00	$344.63	**$192.00**	**$376.00**
6	$324.13	$640.87	**$354.00**	**$699.00**
8	$501.60	$995.77	**$547.00**	**$1,086.00**
10	$704.00	$1,402.00	**$768.00**	**$1,529.00**

In addition, there are three proposed new fees for services that have been historically provided at no charge to the customer. These new fees are summarized in the following table and defined as follows:

Fee Description	*Proposed Fee*
After Hours Field Service Fee Imposed on a customer request for service at such a time or in such a manner that requires the Waterworks staff to conduct a service visit after normal business hours (i.e., a request extending the work day to an overtime status.)	**$70**
Water Exam Fee Imposed when a Waterworks Service Inspector visits a customer's location at the customer's request for the purpose of determining whether a leak exists on the customer's side of the meter.	**$25**
Bill Request Administrative Fee Imposed when a customer requests printed copies of billing history. Histories are generally mailed to customer.	**$5**

The user fee increases are largely unavoidable, as they are driven primarily by regulatory requirements. I am confident that every effort had been made to reduce costs where possible, increase operational efficiencies, use reserves of the funds as appropriate, and yet there are no other options under the burden of these mandates except for recommending these increases. Below is a chart that shows the potential impact on an average homeowner of all the rate and fee changes that this recommended budget contains. Taking into account the average decline in real estate assessments in the upcoming year, the typical homeowner will still have lower Real Estate Tax burden than in FY 2008, while retaining the current service level that they enjoy.

This table is based on the values associated with a household of four and had an average 2014 real assessment of approximately $171,030. (This same median assessment valuation was $201,350 in FY 2009.)

FY 2015 Impact on Typical Household	*Weekly Increase*	*Monthly Increase*	*Annual Increase*
Real Estate Tax	($0.45)	($1.96)	($23.55)
Stormwater Fee	0.40	1.75	21.00
Solid Waste Fee	0.50	2.17	26.00
Sewer User Fee	0.00	0.00	0.00
Sewer Service Fee	0.92	4.00	48.00
Water Fees and Rates	0.23	1.00	12.00
Total Impact	**$1.60**	**$6.95**	**$83.45**

MOVING FORWARD

I believe this operating budget recommendation positions the City and our community for the future, and places the emphasis on funding on some of the most critical areas of concern.

Over the next year, the current economic conditions set the parameters of the City's fiscal environment which we expect to be characterized by slow growth, with emergent optimism. Real estate values should stabilize, and cuts from the State appear to be leveling off. To be realistic, dynamic revenue increases from either real estate or State programs are unlikely. The local tax base should continue to grow modestly. While the future path the economy will take still remains unclear, current trends suggest that this community will largely be prepared to manage its fiscal challenges, meet its commitments, and take advantage of opportunities that arise.

Moving forward, we will continue to use our Strategic initiatives as guides for making judgments about where to invest our limited resources. This budget is fully consistent with these priorities and strengthens the community's ability to make further progress in the years ahead.

CONCLUSION

In summary, I have submitted a balanced budget with no service delivery reductions. The Recommended Budget includes necessary rate and fee increases, and additional reductions to achieve the level of City operations desired by our citizens and/or mandated by higher levels of government. This recommended budget achieves the objectives of funding our pension and health care obligations, maintaining funding to Schools and to our infrastructure, funds initiatives that supports our Strategic Priorities, and provides a salary adjustment and future investment for our valued employees. In order to lessen the impact of the rate and fee increases, I am recommending difficult but necessary, practical reductions where appropriate. These are all significant accomplishments, given the constraints that we face. This Recommended Budget maintains the City's hard-earned, well-deserved reputation for strong financial management.

My staff at all levels and I have worked very hard to develop a budget that is responsive to the current economic climate, and yet maintains essential core services for our citizens. I particularly want to acknowledge the staff of the Department of Budget and Evaluation for their diligence during this process.

While this memorandum highlights the budget in general, specific areas of interest will be detailed in Budget Position Papers, which will be delivered to you on or around April 4. All budget documents will be made available to the public on the City's web site and in all Newport News public libraries.

I believe that this FY 2015 Recommended Operating Budget is responsive to our organizational and community needs and that I am pleased to present for your consideration. I will work with you and the citizens of Newport News to finalize this budget through upcoming work sessions and public hearings. I thank you for your support.

James M. Bourey

JMB:LJC