

Summary of Changes from Proposed to Adopted Budget

City Council adopted the FY 2013-14 Budget on May 14, 2013. The Budget was adopted as Proposed, with the exception of additional funding for School Operations and School Capital Projects. The summary of changes is as follows:

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| CITY OF PORTSMOUTH ADOPTED BUDGET |
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| | FY 2013 Adopted | FY 2013 Amended | FY 2014 Proposed | FY 2014 Adopted | Change from Proposed | |
|-----------------------|--------------------|--------------------|---------------------|--------------------|----------------------|----------|
| | | | | | \$ Change | % Change |
| General Fund | \$223,225,100 | \$229,730,442 | \$231,385,811 | \$232,685,811 | \$1,300,000 | 0.6% |
| Other Operating Funds | 156,626,385 | 156,626,385 | 156,123,560 | 156,123,560 | 0 | 0.0% |
| School Budget* | 164,640,714 | 169,965,714 | 164,370,818 | 165,670,818 | 1,300,000 | 0.8% |
| Combined CIP | 38,508,337 | 38,508,337 | 58,797,923 | 59,997,923 | 1,200,000 | 2.0% |
| Total | \$583,000,536 | \$594,830,878 | \$610,678,112 | \$614,478,112 | \$3,800,000 | 0.6% |

* The Total School Budget was not available at time Proposed Budget was published. The Proposed amount reflects the total funds with the City Manager's recommended local funding level.

The use of the additional Adopted appropriations is summarized below.

Use of Additional Funding

General Fund

| | |
|-------------------|-------------|
| School Operations | \$1,300,000 |
|-------------------|-------------|

| | |
|---------------|-----------|
| School Budget | 1,300,000 |
|---------------|-----------|

Combined CIP

| | |
|-----------------|------------------|
| School Projects | <u>1,200,000</u> |
|-----------------|------------------|

| | |
|------------------------------|---------------------------|
| Total Increase from Proposed | <u><u>\$3,800,000</u></u> |
|------------------------------|---------------------------|





April 1, 2013

The Honorable Mayor and Members of City
Council City of Portsmouth, Virginia

Dear Mayor and Members of Council,

I am pleased to submit my Fiscal Year 2013-2014 Proposed Operating and Capital Improvement (CIP) Budget for your consideration.

I am happy to report that we have balanced this budget without increasing the real estate tax rate, the personal property tax rate, the utility rate, stormwater rate, or the solid waste collection fee. In addition, this budget includes a number of bold initiatives that are forward thinking and which will position the City for a financially stronger future.

We have prepared this budget during an economic period that continues to be challenging for cities and counties in Virginia and the nation as a whole. In the aftermath of the worst economic downturn since the Great Depression, localities across the nation have struggled mightily to fend off decline. They have been battered by the recession and forced to cut services, infrastructure maintenance, staffing, and reserves. As you are well aware, Portsmouth took similar actions as a result of its decline in revenue. In spite of this backdrop, this budget accomplishes some very significant things for our community.

This proposed budget does the following:

- Maintains core municipal services
- Invests in our employees and our community
- Implements three bold new initiatives:
 - Quickly restores the City's two closed pension systems to a fiscally sound funding level
 - Eliminates the Social Security Offset for retirees of the City's closed Portsmouth Supplemental Retirement System plan
 - Provides curbside recycling to our residents at no additional cost

Office of the City Manager

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- Continues the City's commitment to its Public Schools at an adequate funding level
- Avoids any new tax increases, utility rate increases, layoffs, or furloughs
- Maintains city staffing levels necessary for departments to accomplish their missions
- Reinvests in critical infrastructure
- Invests in Civic Organizations and the Arts
- Promotes sustainability, livability, education, human capital, economic development and fiscal stability

The overall proposed budget for the City of Portsmouth is \$446.3 million for Fiscal Year 2013-2014. This amount does not include the Schools' total budget for we have yet to receive that amount from the School System.

The size of the budget is indicative of the breadth, depth, and diversity of services, projects, and activities that the City of Portsmouth undertakes for public safety, education, quality of life, economic development, infrastructure maintenance and transportation. The two largest components of the budget are the General Fund and Utility Fund.

The proposed General Fund operating budget is \$231.4 million, and the proposed Utility Operating Fund is \$43.7 million. The General Fund, Utility, and Parking components of the proposed CIP Budget total \$58.8 million. One can find a comprehensive list of the funds included in this budget on pages 3-9 through 3-11 of this document.

Significant Budget Initiatives

The City's overall budget strategy centers on actions to strengthen Portsmouth's financial position, to support a healthy environment, to invest in our employees, schools, critical systems and infrastructure. These actions include:

- Issuing pension obligation bonds to immediately restore the City's pension plans to financial health and to eliminate the Social Security Offset for retirees
- Instituting curbside recycling to our residents
- Providing raises for our employees and retirees
- Filling positions that have long been vacant

- Continuing the City's support for education
- Identifying strategies to reduce subsidies for enterprise funds
- Investing in capital infrastructure

Pension Obligation Bonds

The City has two closed Pension Plans: Portsmouth Supplemental Retirement System (PSRS) and Fire & Police Retirement System (F&P).

All pension plans have two basic components: assets, which is essentially the available cash in the plan, and liabilities, which consist of the retirement benefits that we pay. These two components must be in equilibrium for current and future benefit payments. For every one dollar in liability, we should have one dollar of assets. Instead, the City's two closed pension plans have 28 cents and 32 cents of assets per dollar of liability. This is a critically precarious ratio. The City has been funding the Annual Required Contribution (ARC), but unfortunately that has not been sufficient to increase the funding levels of the plans.

There are essentially two problems affecting the fiscal viability of these two plans: insufficient cash flow and assets that have deteriorated to the point where one bad year of investment losses could jeopardize their solvency. It will take \$150 million just to get the plans to 80 cents of assets per dollar of liability, but that would be a significant improvement and would bring the funded status of the plans to an acceptable level. The quickest way to get us to that 80 cent level is through the issuance of Pension Obligation Bonds. City Staff and the City's Financial Advisor presented to City Council information about these bonds in a number of public meetings between January and March, 2013. The City is moving forward with issuing Pension Obligation Bonds and expects to close on a bond deal by the end of June.

Eliminating the Social Security Offset creates an actuarial liability of \$21 million; in order to fund this liability, the pension obligation bond issue will include this additional amount.

Raises for Employees and Retirees

Our employees are our most important asset. They ensure that our residents receive a high level of customer service and responsiveness. As a result of the severe economic downturn, our general employees have not had a raise for the past four fiscal years. During that same time period, we implemented a new pay plan for our sworn Police and Fire employees; with this new pay plan, we have given our sworn public safety officers pay increases each year except for Fiscal Year 2011-2012 and Fiscal Year 2012-2013.

This Budget proposes a three percent increase for general wage employees effective July 1, 2013. The State Budget includes a three percent raise for Constitutional Offices, effective August 1, 2013 with the State Compensation Board paying for the State portion of that cost. However, in order to be consistent with the date that our general employees will receive their increase, I am proposing that all of the Constitutional Officers and their employees receive the three percent increase on July 1. The Constitutional Officers and their employees provide a valuable service to our citizens, and we should compensate them for their

outstanding service.

The budget also reinstates step increases for Sworn Police and Fire employees, which were suspended in Fiscal Year 2012-2013.

Just as important as taking care of our current employees, we must recognize the financial needs of our retirees – those persons who devoted a good part of their lives to the betterment of our City. In this regard, this budget includes a 1.5% Cost of Living increase for retirees of the PSRS and F&P plans.

As for our pay plan structure for our general employees, in addition to not giving our general employees a pay increase over the past four years, we also have not adjusted the structure of our pay plan as it relates to the marketplace. Consequently, our pay structure is approximately four percent below that of the average in the marketplace. The general wage increase that I am recommending with this budget does not adjust the structure of the pay plan for our general employees as it relates to the marketplace. We will study the relationship of the competitiveness of our pay plan with the start of Fiscal Year 2013-2014, and we will provide you with the results of our study and recommendations during the course of the budget year.

Quality Service Delivery

Over the past several years, the City has maintained a high number of vacancies in departments in an effort to make sure that expenditures remained within available revenues. This has had a crippling affect on departments hindering them from effectively accomplishing their missions. As recent as December, 2012, approximately one-fifth of our budgeted positions were vacant. If we are going to be successful in delivering high quality services to Portsmouth residents, then it is vital that departments have the appropriate complement of staff. I began authorizing departments to fill needed vacant positions in December, and we will continue to fill mission critical vacancies in a timely manner. Prior year budgets included a five percent vacancy factor. This budget eliminates the vacancy factor for the Constitutional Offices because they do not generate vacancy savings due to the nature of the funding that they receive from the State. In future budgets, we should consider lowering the vacancy factor to reflect departments' actual experience now that positions are being filled more quickly.

In addition to filling key vacant positions, we also evaluated whether or not we could eliminate certain long standing vacant positions. There are two departments, Permits and Inspections and Marketing and Communications, where positions are permanently eliminated in this budget, generating a net savings to the City. With this budget, we are eliminating four combination inspector positions; in addition, we are eliminating a webmaster and a video production position because an outside contractor is now doing that work.

Local Support for Education

City Council has consistently had a goal of maintaining a high quality public school system. Even though I am recommending that you appropriate a smaller amount of local funds to the School System, this budget continues this goal. I am recommending that you decrease the amount of local funding to reflect the school system's actual operational expenditures in recent years, escalated for anticipated State supported salary increases. You appropriated

to the School System a total \$53.8 million in local funds for Fiscal Year 2012-2013. This budget recommends that you appropriate the sum of \$46 million for Fiscal Year 2013-2014, a reduction of approximately \$7.8 million.

We have analyzed the School System's expenditures for the past several years as presented in the School System's Comprehensive Annual Financial Report (CAFR) and the State Superintendent's annual report on our School System's spending. Based on this analysis and implementing some important cost saving measures, we conclude that the School System will have adequate funding to continue its program of providing high quality education to the children of Portsmouth.

As for the cost saving measures, City and School staffs have identified several support services where there are opportunities for partnering to provide services at a significant lower overall cost to Portsmouth taxpayers. The most significant opportunity for savings is for the Schools to combine their health insurance coverage and plan management with the City and to change from a fully insured to a self-insured program. The City's health insurance consultant, Mercer, has evaluated School claim data, and he estimates a savings of approximately \$3.3 million annually from this change. My budget recommendation assumes that we can implement this partnership on January 1, 2014 thus generating one-half year of savings. In addition, the City and Schools are moving forward on having the City Fleet Management take over maintenance of School buses and vehicles. The City is ready to take over that function as early as July 1, 2013. We estimate that the Schools will save at least \$100,000 per year from this change. Another opportunity for budget savings is to combine certain City and School financial functions such as purchasing and payroll, which should produce savings of at least \$100,000 per year as well.

Beginning July 1, 2013, this budget recommends that we fold the School System's school bus replacement program into the City's equipment replacement program. In this regard, I have included \$1.0 million in the City's proposed CIP appropriation for Fiscal Year 2013-2014 to replace school buses, and I have included \$1.0 million per year for the subsequent four years of the CIP for the continued annual replacement of school buses.

Strategies to Reduce Subsidies for Enterprise Funds

The City operates several enterprise operations, which are intended to be self-supporting through fees and revenues generated by their programs. The largest City enterprise operation is the Water and Sewer Utilities fund, which successfully covers 100% of its operating and capital costs.

There are three other funds that are intended to be self-supporting, but which have required subsidies from the General Fund in order to fully pay for their costs. We are evaluating options and strategies to make these funds fully self-supporting. The most significant General Fund subsidy is to the Golf Fund, which we project to be almost \$1.3 million for Fiscal Year 2013-2014. This subsidy has been growing rapidly each year, and now is equivalent to about two-cents on the real estate tax rate.

In order to reduce this subsidy, we propose to implement in 2013 new pricing strategies for golf fees with a goal of increasing Golf Fund revenues. Golf fees have a high elasticity of demand, and yet our City Code dictates a very rigid pricing schedule. Consistent with the

Portsmouth Golf Courses Golf Operational Assessment Report (E.L. Hamm, Inc., May 2011), we recommend amending the City Code to give the City Manager and his designee the authority to adjust golf fees so as to attract more play at our two golf courses. For example, with this marketing concept, the Golf Manager may set early-bird or twilight rates, allow golfers to purchase three rounds and to get the fourth free, or play for free on one's birthday. This will give the Golf Manager the flexibility to periodically offer discount packages and specials in order to optimize play thus increasing revenues.

Because we have not previously had this pricing flexibility, we conservatively forecast no increase in Golf Fund revenues for this budget. We will use the experience that we gain with this new marketing plan in developing the golf revenue forecast for the 2014- 2015 budget.

The two other enterprise funds that require General Fund subsidies are Willett Hall and the Parking Authority. As you know, we recently briefed you on the conditions at Willett Hall. During the course of the next fiscal year, we will evaluate the revenues and operations for both of these funds, and we will develop recommendations for City Council's future consideration.

Investments in Capital Infrastructure

The proposed CIP continues maintenance and improvement of vital City infrastructure, and it includes those projects whose products have a long life as opposed to maintenance-type projects. In the recent past, the City has paid for a number of ongoing capital maintenance costs by issuing debt instead of cash funding the work.

Prudent financial practices recommends that the City should cash fund those maintenance costs that occur each year and only debt fund projects that have a useful life that is at least equal to the amortization period of the bonds. We will follow this recommendation with the proposed CIP. Instead of debt funding maintenance-type items, we will cash fund these items. In this regard, this budget proposes to use \$4.5 million of available General Fund balance to cash fund capital projects. Section 14 of this document provides a complete listing of these projects. Here are some highlights of this listing:

- \$1 million for an ongoing School Bus replacement program
- \$325,000 to fund recreational activities including lighting for athletic facilities, outdoor facility repairs, and equipment costs for Paradise Creek Nature Park
- \$917,042 for upgrades to important financial and public safety computer systems
- \$1.7 million for maintenance of City buildings and Seawall
- \$225,000 for parking garage repairs

The proposed CIP includes an additional \$1 million in funding to complete construction of a new Behavioral Healthcare Services (BHS) building, to be located on the campus of the existing Department of Social Services/Portsmouth Health Department building. The new 30,000 square foot building will house the BHS Administration, Mental Health and Substance Abuse operations and clinic for direct service to citizens. We anticipate the

completion of construction by the end of calendar year 2014.

Revenues

As for the General Fund, one penny on the real estate tax rate generates \$677,782. Again, this budget does not propose an increase in the real estate tax rate.

We project a very slight increase in revenues for Fiscal Year 2013-2014, reflecting the continued slow economic recovery. Specifically, we anticipate that our base revenues will grow no more than one percent over the actual revenues for Fiscal Year 2012- 2013.

As for the Utility Fund, one penny on the water rate generates \$76,000 in revenues, and one penny on the sewer rate generates \$30,000 in revenue. This budget does not propose any increases in utility rates.

Even though we lost a major utility fund customer, Smithfield Foods, we anticipate utility revenues to remain strong throughout Fiscal Year 2013-2014. Our cash situation is such in the Utility Fund that we are able to cash fund some capital projects that we had previously planned to debt finance. Again, we are able to balance the Utility Fund budget without increasing the water and sewer rates as originally forecasted.

A Few Fee Changes

The budget does include a limited number of proposed fee changes in the General Fund, as described below:

- Increase the Ambulance fees to ensure that the City receives the maximum allowable Medicare reimbursement to cover the cost of providing Emergency Medical Services. These increases are as follows:
 - o ALS-1 Emergency from \$375.00 to \$511.19
 - o ALS-2 Transport from \$568.00 to \$739.88
 - o BLS Emergency from \$328.00 to \$430.88
 - o Mileage from \$7.00/mile to \$8.79/mile
- Increase the Police Concealed Weapon permit from \$15 to \$50. The current \$15 fee goes to the State. This increase will provide local dollars to underwrite the Police Department's costs in processing the permits.
- Adjust Museum fees to provide a discount for group tours and special events.
- Increase the Parks & Recreation Six to Six Program monthly fees as follows:
 - o Before School Care from \$120.00 to \$140.00
 - o After School Care from \$170.00 to \$190.00

Use of General Fund Balance

We have some additional good news to report. This proposed budget reduces the City's dependence of using the General Fund Balance for reoccurring operating expenses. For the current fiscal year, the City used \$2,419,041 to initially close the gap between General Fund operating revenues and expenditures. We worked hard to reduce this number in developing this budget proposal. This proposed budget uses \$1,171,332 for this purpose.

Future Operating Budgets

While we have balanced this proposed budget without a need for increasing the real estate tax rate, we do have new expenditures that will come online in Fiscal Year 2014- 2015 and Fiscal Year 2015-2016. For example, we have the next phase of the debt service on the new courthouse and anticipated Virginia Retirement System cost increases. Unless this sluggish economy heats up in these future years, then we may have to increase taxes to maintain existing service levels.

Budget Format

As you will see, we have changed the format of this budget in order to provide more transparency and more detail. Each section of this budget includes more detail than previous years' proposed budgets. We have also added an appendix that gives a line-item detail for each of our funds.

We want you to have the comfort that you have sufficient information for setting your budget priorities for Fiscal Year 2013-2014.

Conclusion

I recommend that you give this proposed operating budget and proposed CIP your favorable consideration by adopting the same. Despite our sluggish national economy and its impact on our community, this budget supports Council's 2030 Vision Statement, and it undertakes multiple bold initiatives that will have a lasting benefit on our City's quality of life and fiscal soundness. It does all of this without increasing our real estate tax rate or utility fees.

Again, I recommend that you adopt this budget as presented.

Respectfully submitted,

A handwritten signature in blue ink that reads "John L. Rowe, Jr.".

John L. Rowe, Jr.
City Manager