

Adopted Operating and Capital Budget FY 2011

Transmittal Letter

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MEMORANDUM

TO: Mayor Thomas Tomzak and Members of the City Council
FROM: Beverly R. Cameron, City Manager
Mark Whitley, Assistant City Manager
DATE: September 10, 2010
SUBJECT: Transmittal and Summary – FY 2011 Budget

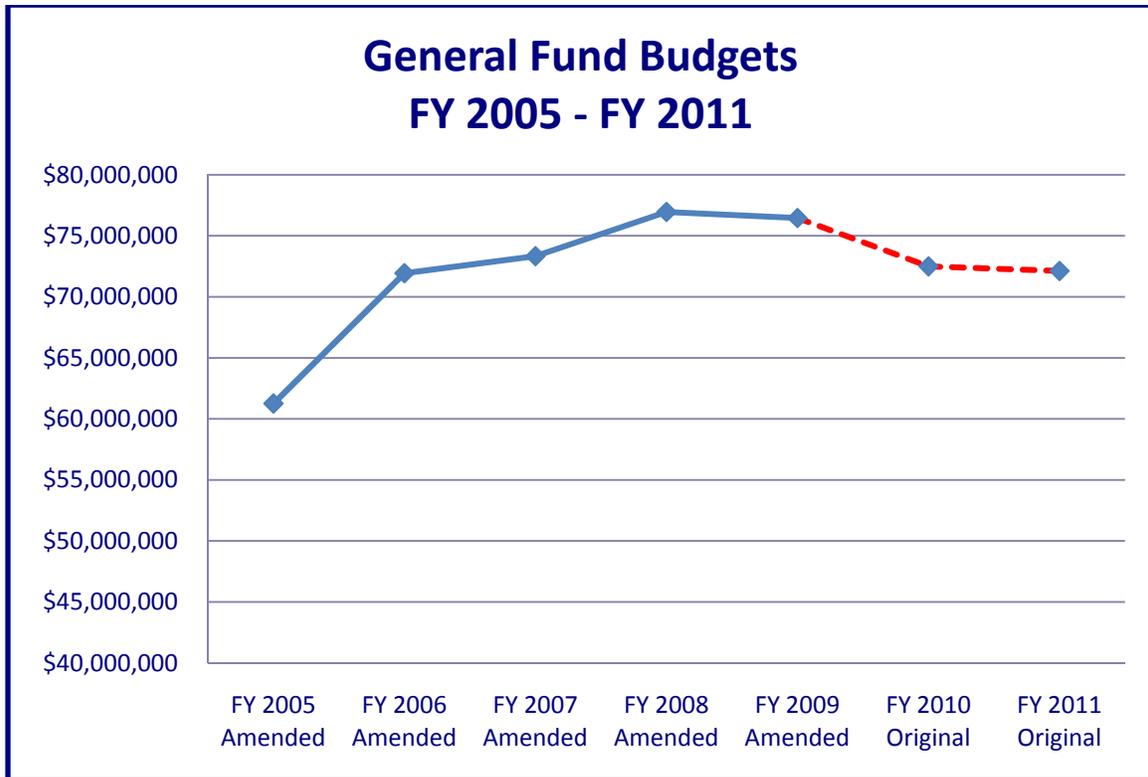
INTRODUCTION

We are pleased to transmit the Adopted Operating Budget for Fiscal Year 2011. The budget is balanced, as required under state law. However, it should be noted that the City balanced the budget using fund balance reserves, and current expenditures exceed current revenues. The proposed General Fund Budget totals \$72.2 million, a decrease of 0.5% over the original FY 2010 General Fund Budget.

The FY 2011 budget reflects the fiscal challenges of the City. The nation is in the midst of one of the worst recessions in many years, and City revenues have suffered as a result. In response, the FY 2011 budget continues the recent trend to reduce overall General Fund spending. Services and personnel have been cut. The FY 2011 budget will be austere. However, there are positive trends in the local economy, which may enable the City to begin a slow process of re-investing in deferred maintenance and capital spending over the next two-three years.

OVERVIEW

The chart below shows the trend in General Fund budgets over the last several years. The FY 2010 and FY 2011 budgets are original budgets, while years FY 2005 through FY 2009 are final budgets after amendments. The City reduced spending in FY 2009, which was the first General Fund budget in several years to decline, in spite of inflation and an additional transfer to City Schools that year of \$1 million. The FY 2010 and FY 2011 budgets continue this downward trend.



Although significantly reduced in FY 2011, the City’s structural deficit of expenditures in excess of revenues remains, and requires use of \$500,000 in fund balance. This use of balance is equivalent to the original amount of the General Fund Contingency in the Recommended Operating Budget. Even with the use of balance, the City is within the bounds of its fund balance policy of maintaining 12% of the prior year revenue in the General Fund undesignated unreserved balance.

BROADER TRENDS AFFECTING THE BUDGET

The City, the region, and the Commonwealth have all been impacted severely by the national economic downturn of the last couple of years. However, the City has been fortunate in that a strong retail base has been maintained, and in the past year several stores have filled vacancies or announced plans to fill vacancies in major commercial areas. Examples of new retail that has either recently come to or is coming to the City include:

- H.H. Gregg, an electronics retailer, in Central Park
- Bavarian Chef, a restaurant, in the old train station downtown
- Hobby Lobby, a hobby and crafts store, in Central Park
- Wegman’s Grocery, which just completed its first full year of operations in Celebrate Virginia South.

The City has also been very fortunate during FY 2010 to see construction and grand opening of the Print Innovators plant in the Fredericksburg Battlefield Industrial Park, and the Eagle Village mixed use re-development at the intersection of Jefferson Davis Highway and College Avenue. The Surgi-Center, currently under construction off

Dixon Street, will also provide a major commercial investment in the Dixon Street corridor. Patient First has also opened a new medical center at the entrance to Central Park off State Route 3. The City has also seen the benefit of a full year of operations from the new Courtyard by Marriott downtown, which has been good for both the City's General Fund and the Parking Fund, as demand for parking has increased in the Sophia Street Parking Garage.

There are also larger trends affecting the Commonwealth, which has a major impact on the City budget. The City counts on assistance from the Commonwealth to fund a fair share of operations for the Constitutional Officers. The state also provides funds to the City for street maintenance, law enforcement assistance, and a variety of other purposes to a smaller extent. The state also provides funding for school operations – approximately one fifth (21.1% in FY 2011) of the school operating budget comes from aid from the Commonwealth. The national recession has reduced state revenues, and in order to balance the state budget the General Assembly has reduced aid to localities. The City does not anticipate that aid from the Commonwealth will increase significantly in the near future unless it is formula-driven, such as increased school enrollment driving up state aid based upon enrollment.

OVERVIEW OF MAJOR OPERATING FUNDS

General Fund

The total appropriation recommended for the **General Fund** is **\$72,120,405**, which represents a 0.52% decrease from the Adopted FY 2010 budget.

Social Services Fund

The total appropriation recommended for the **Social Services Fund** is **\$4,988,290**. This is an increase of 17.75% from the adopted FY 2010 budget. The local transfer from the City's General Fund to assist in supporting the operations of the Department of Social Services is \$823,000, which is effectively the same level of transfer as the original adopted transfer in FY 2010 of \$822,830. The City amended the budget during FY 2010, and the end-of-year transfer for FY 2010 for DSS is \$832,080. The cost of operations for this fund is shared between the City, state, and federal governments.

The DSS lost two positions through attrition during FY 2010. The increase in funding level results from increased demand for service, and is largely funded by increases in federal and state support for benefit programs.

City Grants Fund

The total appropriation for the **City Grants Fund** is **\$1,340,925**. This appropriation is 6.78% more than the original appropriation in FY 2009. The City Grants Fund includes various state and federal grant projects, plus a few local programs with dedicated self-supporting revenue streams. The City Grants Fund budget is amended by the City Council from time to time as new grants are awarded, and also amended after the close of the fiscal year to update balances on existing grants.

Water Fund

The total appropriation recommended for the **Water Fund** is **\$3,446,415**. This funding represents a decrease of 2.41% from the original budget in FY 2010. The City

last increased water rates by 2% in conjunction with the FY 2010 budget, and will need to evaluate whether and when to increase rates in FY 2011.

Wastewater Fund

The total appropriation recommended for the **Wastewater Fund** is **\$6,050,802**. The budget represents an increase in the overall fund from FY 2010 of 3.92%. The increase is necessary as a result of increasing operating costs at the Wastewater Treatment Plant. In addition, the City has begun to pay the debt service on four major sewer line replacement projects: City Dock Sewer, Smith Run Sewer, Hazel Run Sewer, and Kenmore Watershed. Debt service for the Wastewater Treatment Plant renovation project also begins in the FY 2011 budget. The City included a 5% increase in wastewater service charges in FY 2010 to meet rising costs, and will need to evaluate whether and when to increase rates during FY 2011 to meet the increased debt service and operating costs.

Transit Fund

The total appropriation for the **Transit Fund** is **\$6,287,967**. This is an increase of 3.92% over the original FY 2010 appropriation. Ridership has declined slightly over the course of FY 2010, as fares were increased, gasoline prices fell, and other jurisdictions reduced funding, forcing service cuts.

The City's demonstration grant for VRE feeder service includes two routes, one of which (Cowan Boulevard) will be eliminated in FY 2010 to save funds. The ridership on the route was low.

Parking Fund

The total appropriation approved for the **Parking Fund** is **\$643,036**. This represents an increase of 0.67% over the FY 2010 appropriation, and represents the same level of service that was provided in FY 2010. The new downtown hotel, which opened in July 2009, will use the garage and provide more operating revenue to the garage.

Comprehensive Services Act Fund

The total appropriation approved for the **Comprehensive Services Act Fund** is **\$1,250,510**. This fund is for mandated services for at-risk youth that is a shared responsibility of the state and the City. The City's local transfer in FY 2011 will fall to \$563,240, down from \$665,550 in FY 2010 and \$769,427 in FY 2009. The lowered transfer level to the CSA Fund has aided the overall effort to reduce General Fund spending levels. Based on the current service population, the staff is able to forecast a lower total expenditure level for the upcoming fiscal year. However, the Comprehensive Services Act is, for many services, a mandated program, and if the service population or its needs should change the City may have to add resources to the CSA Fund.

Riparian Lands Stewardship Fund

The total appropriation in the **Riparian Lands Stewardship Fund** is **\$82,717**. This is a 5.79% increase over FY 2010 funding levels. There are no substantive service changes in this fund. The fund serves as the permanent protected endowment fund for the City's river steward program.

REVENUE HIGHLIGHTS

Revenues – General Fund

The City did not increase any tax rates in the FY 2011 budget. One tax rate, the admissions tax, will increase from 5% to 6% as a result of Council action in 2009 to implement the agreement with Kalahari Resorts. There are signs of improving economic activity and new construction in the City, which will help to increase revenues slightly and offset some of the negative trends in state-shared revenues.

Revenues- Water and Wastewater Funds

After raising water and sewer rates each year in FY 2008, FY 2009, and FY 2010, the City did not raise rates at the beginning of FY 2011. However, the City will need to raise the rates in the future, as needed capital reinvestments in transmission lines and the Wastewater Treatment Plant have increased debt service costs, particularly in the Wastewater Fund. The City will need to evaluate an interim rate increase at some point during FY 2011, and has also included funding for a rate study to outline a future financial plan for the Water and Wastewater Funds.

GENERAL BUDGET EXPENDITURE HIGHLIGHTS

The reductions in expenditures needed to balance the FY 2011 budget totaled over \$5 million from FY 2010 levels, and represent meaningful and consequential reductions to City programs and services.

Many impacts from these reductions will be easy to discern – for example, the elimination of the Rental Housing Inspection Program, or postponement of the General Property Re-assessment. Others will manifest themselves in slower response times to requests for information, or slower internal processes, or decreased ability to respond to opportunities or initiatives as various work groups absorb the loss of personnel and re-parcel out the workload to remaining workers.

Major Program Reductions for FY 2011

In evaluating the FY 2011 budget, the City staff and City Council attempted to identify service cuts that could be sustained over the long-term. In addition, the City was able to postpone major expenditures that will need to be re-instated, but which still constitute current savings as contracts are postponed or the useful life of assets are extended. Examples of program cuts for FY 2011 include:

- Elimination of the School Resource Officer position at Walker-Grant MS
- Elimination of the Budget Manager position in the City Manager's Office
- Elimination of an additional Police Officer position
- Elimination of the Rental Housing Inspector program
- Postponement of the General Property Re-assessment

Schools

The transfer to City Schools remains the same in FY 2011 as in FY 2010 - \$24,028,000. The transfer is a reduction of \$700,000 from the FY 2009 level. The City Schools will benefit significantly from a change in the state's local composite index. The local composite index is the formula that the state uses to allocate state education funding

between the various localities. Based on the latest figures, the LCI for the City fell from 0.7943 to 0.7763, which helps alleviate the impact of state-wide cuts in education funding.¹ The school enrollment is also increasing – in 2009 the Average Daily Membership, a measure of school enrollment, was 2,655. That number increased to 2,793 in 2010. The increased in enrollment will mean increased funding from the state, but additional strain on the school systems' resources.

In addition, the City Schools have been able, in FY 2010, to take advantage of increased federal funding for education to help meet ongoing school needs. The increase in federal and state funding will help offset the frozen levels of City support, but much of the federal funding is from the “stimulus package” and will expire over the next couple of years.

Employee Salaries

The City Manager's Recommended Budget included a recommendation for four furlough days in response to the ongoing economic recession and its projected impact on City revenues. However, during the spring the City Council, in its review, was able to use a combination of other spending cuts and improving revenue pictures to eliminate the four furlough days. There are no furloughs included with the FY 2011 budget.

However, the City Council retained the \$70,000 turnover credit, which will need to be offset by the close of the year from turnover savings in the General Fund. In addition, there was no raise or bonus for City employees. The last general raise for City employees was a 2% cost-of-living raise effective July 1, 2008 (FY 2009).

Employee Benefits – Health Insurance

As is the case with many employers, the City faces strong inflationary pressure on health insurance premiums. The City offers three health plans to employees – an HMO, a standard fee-for-service based plan, and a plan that offers payments after a deductible. The City and employees share premiums, with the City paying the majority of the premium as an employee benefit. The percentage of the premium paid by the employee varies with the level of coverage. The City's plan is a self-insurance plan, with the City contracting for administrative services and re-insurance for individual claims and the group.

Unfortunately, health insurance costs continue to rise at a rate that far exceeds general inflation in the economy. This underlying trend, plus a poor claims year in FY 2009, meant that City costs for health insurance were set to rise substantially. In anticipation, the City went through procurement for administrative services on health insurance for FY 2011, in an effort to contain premium costs. Competition was very good, and the City selected renewal with Anthem. In an additional effort to control the premium increase, the City also decreased slightly the level of benefit. Doctor visit co-pays were raised, as was the out-of-pocket expense limit. An additional cost-savings measure was to increase the Aggregate Stop Loss limit to 120% of forecast claims – up from 115%. This increases the City's risk in the event of a bad claims year, but lowers premium costs for the re-insurance. Finally, the City also added a “plus-spouse” level of

¹ If all things are equal, this would equate to approximately \$200,000 in additional funding for the schools. However, actual funding varies significantly from year-to-year based on the state budget and school enrollment.

coverage to our plans, which allowed employees who previously were forced to pay for “family” levels of coverage to cover only their spouses to pay a lower premium.

Even with all of these cost measures, the City’s expected costs for health insurance rose approximately 7%, and the City expects to pay approximately \$4.4 million in health insurance costs in FY 2011. The City budgets its health insurance costs by using a weighted average per employee cost, based on the different classes of premiums paid by the City. The following table shows the increases in health insurance premiums budgeted over the last several years, which represents the City’s share of the cost.

Budgeted Per Employee Premium Cost	
FY 2006	\$5,500
FY 2007	\$5,900
FY 2008	\$6,250
FY 2009	\$7,100
FY 2010	\$7,800
FY 2011	\$8,500

Employee Benefits – Virginia Retirement System

The City staff was disappointed to learn that the Virginia Retirement System raised the City’s retirement rate from 14.41% to 15.8% for full-time City employees during the FY 2011-2012 biennium. The rate increase was created by an increase in the number of retirees; coupled with a decrease in the number of full-time City employees as the City eliminates positions; combined with the poor investment returns of the VRS over the last couple of years. The City, unlike the state, does not have the option of forcing the VRS to moderate this increase with the idea that the system’s investment performance may improve and help make up some of the losses.

The City was offered an option by the state General Assembly to have new hires pay 5% of their salary towards their pension, which would lower costs for the City. However, the City Council and staff chose not to pursue this course at this time for the following reasons:

- 1) Charging new employees for a portion of their pension benefits creates two classes of employees, and will hinder internal equity and morale
- 2) Charging new employees for a portion of their pension benefits will set the City at a competitive disadvantage for new employees, particularly in fields such as police and fire where the primary competition is with other public sector agencies.

The General Assembly did make other changes to the VRS plan that are effective state-wide, and will serve to lower pension costs in the long run. An example is the “Rule of 90,” which affects general employees and states that full retirement for new employees requires some combination of years of age and service equal to 90 (for example, 30 years of service and 60 years of age). Currently, employees may receive a full retirement at 30 years of service but as young as 50 years old, which creates a significant long-term pension liability for the VRS. However, these changes will only benefit the community in the long-term, as they apply to full-time employees hired after July 1, 2010.

Descriptions of Personnel Changes

The City continued its efforts to reduce the overall size of the City workforce by eliminating six full-time positions in the FY 2011 budget. (It is important to note that after the budget was adopted, the Compensation Board awarded the Clerk of Circuit Court an additional Deputy Clerk position, so the net decrease is five). The City reduced its overall General Fund workforce by 11 full-time positions in the FY 2010 budget. The City reduced 13 full-time positions in the FY 2009 budget, for a total of 30 full-time positions over the last three years. The total number of authorized full-time positions has fallen from a high of 371 at the close of FY 2008 to 341 in FY 2011.

During this three-year period, most, but not quite all, of these reductions have been through attrition. Two employees have been transitioned to part-time status, and one has been transferred to the Water Fund. The City also ended in FY 2009 the informal agreement to carry judicial legal secretaries from the entire 15th Judicial Circuit on the City payroll, with reimbursement from other jurisdictions. Other jurisdictions now have the Judicial Legal Secretaries for their sitting judge on their own payrolls, reducing the City's workforce by four positions.

The overall reduction in positions is a primary reason behind the City's ability to reduce overall expenditures during this period. The following section will describe the job losses seen by the City for the FY 2011 budget.

City Manager's Office – Budget Manager

In FY 2010, the Assistant City Manager, who was serving as Interim City Manager, received appointment to the City Manager position. Also during the course of the year, the Budget Manager was promoted to Assistant City Manager, leaving a vacancy in the position of Budget Manager. This position was eliminated in the FY 2011 budget for savings.

In FY 2009, the City Manager's Office had two Executive Assistant positions. During the year, one of the incumbents was promoted to Clerk of City Council, and the vacancy thus created remains frozen. As a result, the total number of full-time positions in the City Manager's Office over the last two fiscal years changes from five to three.

Legal Services – Replace Full-time with Part-time

The long-serving assistant to the City Attorney retired during FY 2010, and the City is replacing the position with a part-time Paralegal position.

Building and Development Services – Rental Housing Inspector and Permit Clerk

The City is suspending the Rental Housing Inspection program, and the Rental Housing Inspector position will be eliminated in the FY 2011 budget. The City will also be eliminating a Permit Clerk position. The incumbents in the positions have transferred to other vacancies.

Police Department Changes

The City Police Department saw several retirements and vacancies which will result in a variety of changes to the Department in FY 2011. Two Police Officer positions will be eliminated in the upcoming budget – one represents the School Resource Officer at Walker-Grant Middle School, and the other is an Officer position that

functioned in a variety of administrative roles within the Department, including extraditions and special event duties. The City increased funding in contracted services in order to help fill in some of the duties performed by the “administrative” officer, such as prisoner extraditions.

The Police Department also transferred the Police Information Systems Manager position to the Information Technology Department, and closed a full-time Clerk / Typist position and transferred it to Information Technology, where it has been re-created as a PC Technician position. These personnel transfers to Information Technology will enable the Information Technology Department to support the Police Department’s technology function.

Economic Development and Tourism Department

At the time of the FY 2011 budget, the Director of Economic Development and Tourism was filled on an interim basis. The budget included sufficient funding for the Director position, but not the Tourism Manager position. The total number of authorized positions in the Department has fallen from seven to six in the FY 2011 budget.

Other Personnel Changes

The FY 2011 budget eliminated the “Firefighter-Safety” position in the Fire Department and re-created the position as a Safety and Risk Management Coordinator in a new Safety and Risk Management Division, which will help to better track the City’s ongoing efforts to improve the safety of the workforce and reduce accidents.

Capital Outlay – Deferred Maintenance

The City has been forced to defer routine replacements of capital equipment because of the recent declines in the revenue base. Although it is an inexact indicator for the total capital needs of the City, the following table shows the City’s spending on “Capital Outlay,” which is the spending on vehicles, desks, and similar items that need to be replaced on a routine basis.

Capital Outlay (General Fund Only)	
Fiscal Year 2007 (Actual)	\$1,022,901
Fiscal Year 2008 (Actual)	\$1,066,596
Fiscal Year 2009 (Amended Budget)	\$753,861
Fiscal Year 2010 (Original Budget)	\$220,800
Fiscal Year 2011 (Original Budget)	\$483,660

The decline in overall spending for capital replacements can be an effective short-term strategy for dealing with financial shortfalls, as the City has experienced in the last couple of years. In addition, some capital replacement spending (for example, computer replacements) has been undertaken through the capital budgets in the last couple of years. The City did fund a fleet maintenance program in the capital budget for FY 2011, which will assist in maintaining service levels for Public Works, Parks and Recreation, and Police. Nevertheless, the underlying trend of deferred replacements of routine capital items is real, and the City will need to dedicate additional resources in the future to

capital outlay replacements in order to maintain service quality and not unduly increase expenditures for maintenance.

LOOKING AHEAD TO FY 2012 AND BEYOND

The City budget in FY 2011 brings the City's expenditure levels nearly in-line with expected revenues. The City has been conservative in forecasting revenues, and aggressive in containing costs. The City will need to continue to contain costs and consider service cuts in order to free resources; however, unless economic conditions take a renewed downward turn the decline in City revenues will ease.

The major challenges for the upcoming FY 2012 budget year, and the budget years beyond, will shift slightly from aggressive cost-cutting to finding resources to fund maintenance needs that have been deferred because of the recession. The City's population is still growing, which is placing strains on the City Schools and other service areas. In addition, street maintenance, fleet replacements, and other needs have been funded at reduced levels, and will need to be funded so that the City will continue to provide needed services. Part of the deferred maintenance needs of the City include the replacement courts, which will create a major increase in debt service costs for the City, most likely in FY 2013 or FY 2014. The City workforce has absorbed increases in benefit costs with no raises to offset them for two years, and an appropriate and modest increase in compensation levels, either through raises or bonuses, should be considered in the FY 2012 cycle.

In line with the ongoing efforts to restore service cuts, over the next few years the City may need to consider restoring certain full-time positions to the payroll. Certain service cuts will be "permanent," and certain programs may not be restored for the foreseeable future. However, other positions may need restoration in order to meet ongoing service demands for the City.

A new City Council has taken office, beginning July 1, 2010, with two new members. The Council will hold a retreat in November 2010 to set a new round of goals and initiatives for the upcoming two-year term. That goal-setting initiative will set Council's priorities for rebuilding the City's capabilities and addressing the deferred maintenance backlog.

Finally, the City has been notified that by the regional landfill that serves the City and Stafford County (Rappahannock Regional Solid Waste Authority, commonly known as the "R-Board") will need to begin charging tipping fees to the City for trash disposed at the landfill. City residents currently pay for twice-per-week backyard collections through a bi-monthly fee, and the City will need to evaluate whether to raise fees, reduce service levels, or both in order to meet the increased costs for trash disposal.

A NOTE ON THIS BUDGET DOCUMENT

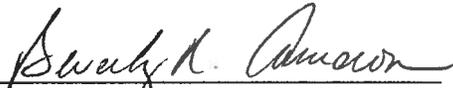
The City has been fortunate in winning the GFOA² Budget Award Document for Effective Budget Presentation over the last four years, including the most recent document for FY 2010. Unfortunately, the City's ongoing efforts to reduce costs led to the elimination of the Budget Manager position, and as a result the City will not be able to meet the criteria for the GFOA Budget Award for FY 2011.

² Government Finance Officer's Association.

The City remains committed to producing an effective and informative budget document; however, there is insufficient time and staff to prepare the document in a way that meets the GFOA criteria.

CONCLUSION AND ACKNOWLEDGEMENTS

In conclusion, the budget for FY 2011 is a responsible spending plan which continues the process of reducing the City's overall spending, but continues to provide the services necessary to meet the needs of the citizens of the City. The final budget represents many hours of preparation on the part of the departments, Constitutional Officers, and outside agencies and many hours of deliberation and review on the part of the staff and the City Council. Many thanks should go to all involved for their efforts in pulling together this important plan.



Beverly R. Cameron
City Manager



Mark Whitley
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