

OFFICE OF THE CITY MANAGER

March 22, 2022

TO: The Honorable City Council
FROM: City Manager
SUBJECT: Recommended FY 2023 Operating Budget

I am pleased to transmit the City's recommended operating budget for the fiscal year beginning July 1, 2022 and ending June 30, 2023.

This recommended budget was developed during a period of ever changing economic conditions. After two years of COVID-19 pandemic impacts, we are experiencing a post-COVID economy; restoration of business and social activities accompanied with high inflation rates. Inflation has created a temporary flux in additional revenue to the City, while at the same time, the City is also impacted by higher costs as a consumer of goods and services. We are well aware that the additional inflation-driven revenue is temporary. As such, our goal with this Recommended Budget is to maintain our investments in core areas that benefit all citizens and address important organizational needs within responsible revenue projections, while ensuring our long term resiliency.

The FY 2023 Recommended Budget continues to move the City's Strategic Priorities of *People, Places, and Government* forward. This Recommended Budget particularly focuses on progressive elements in the *People* Priority including the four goals and objectives: Health, Safety and Well-being; Education and Learning; Opportunity and Economic Prosperity; and Fun, Entertainment, and Culture.

OVERVIEW

The total recommended FY 2023 Operating Budget is \$1,041,373,452, which is an increase of \$69,865,166 or 7.2% higher than the current fiscal year adopted budget. The FY total Operating Budget includes the General Fund, Schools, Waterworks, and all Special Revenue and Trust Funds. The Recommended General Fund Operating Budget is \$568,484,000, which includes \$4,000,000 in Federal and State grant funds. In a year-to-year comparison, the General Fund Budget is \$32,006,457 or 6.0% higher than the revised FY 2022 budget.

REVENUE OUTLOOK

As we transition through the next phases of pandemic recovery, the national economy is experiencing inflationary rates, not seen in a long time and exacerbated by the uncertainty of current world events. While inflation is creating an increase in revenue, we anticipate this current environment to be temporary. We remain confident that the City's core tax base of real estate, personal property, and machinery and tools will remain sound. Accordingly, we must continue to adhere to our strong financial management and conservative budgeting practices.

For the eighth consecutive year, real estate assessments in Newport News have increased. Real estate tax revenue is the largest single revenue source for the City and is the principal revenue in the General Fund. Real estate assessments are primarily a reflection of current market demand for both residential and commercial properties. This year all property types experienced increases in assessed value. This growth is primarily due to increased sale prices for all property types in Calendar Year 2021. Commercial properties are generally valued based on the income generated by the property. Apartments have experienced the highest increase in value for the Commercial sector. For Apartments, significantly higher rents was a contributing factor to the larger than usual assessment increase. In both these markets, increased sale prices and income generated by the properties have contributed to the higher assessment.

The total assessed value of real property has increased by 14.44% over the prior year. While this increase is somewhat tempered by inflationary impacts, it is indicative of higher property values, new development, and reinvestment throughout Newport News.

The FY 2023 Recommended Budget includes a real estate tax reduction of 2 cents per hundred of assessed value, from \$1.22 to \$1.20. If adopted, this will be the first real estate tax reduction since FY 2008. This reduction equates to approximately \$4 million in tax relief for our residential property owners and businesses and will not impact service delivery. It is important to recognize that the current level of assessment growth has a financial impact on our citizens during this inflationary period; however, we have to recognize that this level of growth is short term. As noted, while this adjustment is possible due to historic increases in real estate assessments, we do not expect this level of growth to continue. We also have to balance tax relief with the service needs of our citizens. Therefore, it is prudent to plan for a longer range time period, for when this revenue begins to decline.

Personal Property Tax revenue is estimated at \$59.8 million for FY 2023. The impact of the COVID-19 pandemic has caused labor and supply shortages resulting in a low supply of new vehicles in the automobile and truck markets. This has escalated used vehicle costs. With the Calendar Year 2022 assessment being prepared by the Commissioner of the Revenue, it is anticipated that the Personal Property Tax assessment on automobiles and trucks could increase by an average of 33%. To mitigate this impact on vehicle owners for one year, I am recommending that City Council adopt a resolution temporarily reducing the Calendar Year 2022 assessment rate from 100% to 75%. This assessment change is permissible by State Code, and would be in effect for the Personal Property billing cycles of June 5 and December 5, 2022. There are no recommended changes to the tax rate. This adjustment will result in tax relief to our citizens of approximately \$16.8 million divided between the current fiscal year and the first half of FY 2023.

Machinery and Tools Taxes revenue is continuing to grow to an estimated \$28.9 million, an increase of \$3.3 million over the current year. This growth is mainly attributed to industry expansion in the City.

Still unknown at this time is the General Assembly's determination on altering the localities' ability to continue to leverage one percent of the State Sale Tax on groceries. For the City, this affects \$4.6 million in Sales Tax revenue. This amount has been estimated in the FY 2023 Recommended Budget, with an offsetting reserve established to address the final disposition of the General Assembly legislation.

The performance of Sales and Meal Tax revenues are impacted by inflation, and like Real Estate tax, are estimated to be lower in future fiscal years. Sales Tax revenue is projected to be \$32.8 million for FY 2023. Meals Tax is estimated to be \$31.3 million.

The projection for the Business, Professional, and Occupational License Tax (BPOL) revenue is higher than the current fiscal year by almost \$1.2 million or 6.8%. BPOL revenue is based on business' gross receipts for the calendar year. Through partial closures to full reopening in business operations during calendar year 2022, overall BPOL revenue has been consistently strong in the past fiscal years.

All other revenue sources are estimated based on current fiscal year projections, with growth due to restoration of functions and activities. All

revenues will continue to be strictly monitored for performance as the economic recovery ensues.

EXPENDITURE CHANGES

It is important to recognize that while the City is experiencing increased revenue due to inflationary conditions, the City is also facing the same inflationary pressures in procuring its own goods and services. It is necessary to right-size the base budget to ensure adequate funding to provide for citizen services.

While addressing existing expenses, consideration was given to how to continue, in a viable manner, the efforts on City Council's Strategic Priorities that were started in FY 2021 and expanded in FY 2022. Sustainable integration of the *People, Places and Government* priorities continues to be the fundamental base of this recommended budget.

The list below highlights some of the major initiatives included in the FY 2023 Recommended Operating Budget. A summary of all the FY 2023 proposed Expenditure changes are in the Recommended Budget document under the section *General Fund Expenditures*.

- ❖ ***Strategic Priority - People***
 - Education and Learning
 - Full funding of the School operating request for the fifth consecutive fiscal year,
 - Continued funding for the public-private partnership focused on the City's early childhood learning initiative,
 - Health, Safety and Well-Being
 - Expand the CARE Initiative; convert contracted mental health providers CARE team members to two (2) City positions; add a third CARE team (2 positions) for evening shift,
 - Addition of two (2) Family Services Specialist to participate with paramedics,
 - Convert grant funded Behavioral Health Docket pre-trial officer to one (1) City funded position,
 - Funding to develop workforce program for Four Oaks Day Service Center participants,
 - Addition of one (1) Housing Program Coordinator for case management on homelessness activities,

- Addition of one (1) Commonwealth Attorney position, to meet the State mandated staffing ratios for evidence collection associated with body worn cameras,
- Addition of one (1) Senior Law Enforcement Analyst dedicated to the Police Real Crime Center,
- Opportunity and Economic Prosperity
 - Addition of one (1) SWaM Coordinator for the Purchasing Office to increase participation with Small, Woman-Owned and Minority-Owned business in City contract opportunities,
 - Move Tourism Fund activities (nine (9) positions) to the Communications Department, leveraging upcoming branding initiative for integration in overall City marketing functions,
- Fun, Entertainment and Culture
 - Move Historical Services Fund to Parks and Recreation Department (12 positions to the General Fund),
 - Addition of one (1) Lifeguard position to help manage all aquatic sites.
- ❖ ***Strategic Priority - Places***
 - Addition of three (3) Environmental Police Officer positions as part of an interdepartmental team to address blight, abandoned vehicles, poor lighting, illegal dumping, over grown foliage and abandoned bulk trash.
- ❖ ***Strategic Priority - Government***
 - Quality Government & Innovation
 - Investment in Employee Compensation
 - 5% general wage adjustment and salary reserve targeted for adjustment to lower grade positions,
 - Consideration for establishment of a pension reserve fund.

Investment in Employee Compensation and Development

Remaining competitive in the market is critical to recruiting and retaining employees. Investment in our employees remains a top priority in the recommended budget. A general wage adjustment of 5% is recommended for eligible employees effective July 1, 2022. In addition, \$2.3 million is reserved to do reviews for job/position classes, with a special focus on lower grade positions. For the Police Department, a midnight shift pay differential has been included for both sworn and civilian employees to recognize the additional physical and mental demands of this shift.

Juvenile Services Department employees working in Secure Detention will also be provided a secure detention stipend.

Pension and Health Care Costs

Retirement and Healthcare benefits are companion components of our investment in our employees. Retirement and Health care contributions represent 7.7% of the total budget for FY 2023. The recommended budget continues City Council's commitment to fully fund the Actuarially Determined Contribution (ADC) for the Newport News Employees' Retirement Fund (NNERF) of \$37.5 million city-wide. Due to historic gains in the stock market last fiscal year, the General Fund contribution has decreased over last year. We expect this reduction to be temporary as market conditions change and this fluctuation impacts the annual contribution. As a result, it is recommended consideration be given in the establishment of a pension reserve fund to be used to offset future increases in the contribution.

For the Virginia Retirement System (VRS), the FY 2023 budget also includes \$5.5 million, an increase of over FY 2022 of \$1.6 million.

Health care is a key recruitment tool for both attracting and retaining employees. Health care costs have grown annually across all employment sectors. Despite strong plan management and health/wellness initiatives, we anticipate there will be a slight increase in health insurance premium costs for FY 2023. Health Insurance premiums for active employees alone are \$27 million for FY 2023, representing 5% of the total General Fund expenses.

Debt Service and Cash Capital

Total General Fund support for City Debt Service will decrease by a net \$2,054,009 to \$45,126,084 in FY 2023. This amount is the General Fund payment for: outstanding City General Obligation Debt at \$37,565,008, City supported Schools Division Debt at \$7,303,126, and the Newport News portion of the Peninsula Regional Animal Shelter Debt at \$257,950.

The current lower level of debt stems from issuing bonds during favorable market conditions resulting in excellent interest rates. This was coupled with the added benefit of refunding outstanding eligible bonds, thereby reducing the overall debt costs. With interest rates beginning to rise and the

planned bond issues for the FY 2023-FY 2027 proposed Capital Improvements Plan, it is anticipated that the reduction will be temporary. Cash Capital uses current operating funds for less expensive and more regular capital investments. This approach decreases reliance on borrowing monies for shorter term capital projects. The recommended FY 2023-2027 Capital Improvements Plan (CIP) anticipates using Cash Capital to satisfy the City's Capital Financing and Debt Management Policies requirement of 20% cash capital funding. FY 2023 Cash Capital is \$14,925,125. Of the recommended FY 2023 Cash Capital, \$2 million is dedicated to the School Division for school bus purchases.

Contribution to the Schools Division

Education funding is the largest single component of the annual operating budget. To assist the Newport News Public School's mission to 'ensure that all students graduate college, career and citizen ready' the City provides funding for Schools Operations and Debt Service.

For Operations, the amount of funding is comprised of support for general operations, for grounds maintenance, and information technology program support. For Debt Service, the funding is based on City incurred debt to support School capital projects.

The City's direct funding for School Operations and Schools Debt Service combined is \$123,492,433. This total amount includes \$116,189,307 for School Operations, or an increase of \$2.8 million. This represents full funding of the School Superintendent's specific request for the upcoming fiscal year for the fifth consecutive fiscal year. The Recommended Operating Budget also includes \$7,303,126 for debt service for school capital projects. This calculation does not include separate annual Cash Capital support from the City for school bus purchases in the amount of \$2 million.

RATES AND FEE CHANGES

This budget has been presented with practical, sustainable expenditures within the revenues anticipated to be generated under these temporary and unusual economic conditions. The real estate tax rate change is recommended to decrease by two cents to \$1.20, and the Personal Property Tax assessment level is proposed to be reduced from 100% to 75%. These actions combined give a level of the tax relief to both residents and commercial businesses.

No user fee rates changes are recommended for FY 2023.

LOOKING FORWARD

This Recommended Operating Budget looks forward and continues to enhance operations in a sustainable manner, while continuing our investment in City Council's Strategic Priorities. It places the City in the position to be successful for today and the future. Every effort was made to continue to manage the Recommended Budget in a financially responsible manner to maintain the City's fiscal well-being, providing responsible and responsive tax relief to citizens while delivering critical services.

In summary, you have for consideration a balanced budget focused on City Council's Strategic Priorities. This Recommended Operating Budget meets the objectives of funding pension and health care obligations, support to Schools, debt payments, maintaining infrastructure, and providing a salary adjustment and investment in our valued employees. These are all significant endeavors.

City staff, at all levels, continued to work hard over this past year to maintain services to our citizens in a state of pandemic recovery. I want to specifically acknowledge the staff of the Department of Budget and Evaluation for their hard work in this process. I would also like to thank the Budget Committee and the various Shared Leadership Networks and Departments for their participation, support and commitment in identifying the opportunities to move our City forward in developing the FY 2023 Recommended Operating Budget.

All budget documents will be publicly available on the City's web-site and in the public libraries.

I believe the FY 2023 Recommended Operating Budget is responsive on several levels: to your priorities, our community needs, and enhances the quality of life for all our citizens. I look forward to working with you and the citizens of Newport News to finalize this budget. I thank you for your support.


Cynthia D. Rohlif